INTERNATIONAL ISLAMIC UNIVERSITY ISLAMABAD.

FACULTY OF SHARIAH AND LAW

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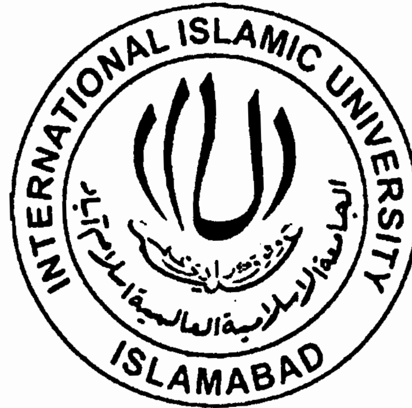

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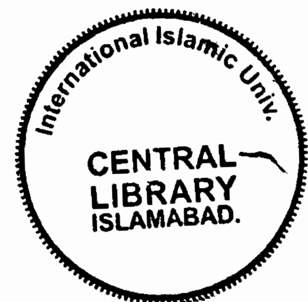
Title of Research

Code of Corporate Governance: Appraisal of Efficiency & Congruency with the International Standards



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Dedication

Dedicated in gratitude and affection to my late mother Kishwar Sultana. May Allah (SWT) shower His blessings on her soul

Preface

The government of Pakistan has set up Securities and Exchange Commission of Pakistan (SECP) in 1997 to lay down the foundation of good corporate governance by building framework for the better management of the companies. The SECP in pursuance of its policy has enacted and enforced various laws and regulations in order to create a good business environment in Pakistan in order to achieve smooth and sustained economic development. In addition to many laws in place, it adopted the Code of Corporate Governance in March 2002 in order to further strengthen the business environment in Pakistan. The framing of this code and its application in letter and spirit is very important for effective corporate governance. The Code of Corporate Governance framed by the SECP is adopted by many listed companies.

The main objectives of thesis are;

1. To study and review the Code of Corporate Governance adopted by the Securities and Exchange Commission of Pakistan
2. To assess the impact and effectiveness of the Code of Corporate Governance on the listed companies particularly in cement, Insurance and leasing sector.
3. To analyze the corporate governance system of the developed countries like United States of America, United Kingdom and China
4. An overview of corporate governance structure, laws in the Pakistan.
5. Suggest suitable recommendations for building effective corporate governances system.

Thesis is divided in five chapters, in first chapter detailed analysis of different definition of corporate governance, which were forwarded by international institutions and reports were carried out. A part from this analysis the significances of the concept of corporate governance and its emergence at international and national level was also examined in detailed.

In second chapter it is analyzed how corporate governance concept received great attention in developed countries. The corporate ownership and control mechanism in the United States of America and how the concept of corporate governance gained momentum in USA was discussed. The reason for the collapses of large US companies such as Enron Corporation, WorldCom etc were discussed in detail which resulted in passing of the Sarbanes-Oxley Act of 2002. The study also highlights the purpose and major provisions of Sarbanes-Oxley Act's. A part from this the developments of the concept of corporate governance in the United Kingdom and different reports that led to the creation of the Combined Code of Corporate Governance in 2003 and subsequently Combined Code of Corporate Governance in 2006 which supersede and replace the 2003 Code, were discussed. The emergence and main provisions of the Code of Corporate Governance in China were also examined.

The third chapter assesses corporate governance models, codes around the world. In addition to that detailed analysis of Pakistan's corporate governance structure, laws and the recent corporate governance reforms brought about by the Security and Exchange Commission of Pakistan in order to bring the corporate law in line with international best practice were discussed.

The main objective of the fourth chapter is to assess the extent and effect of the implementation of the Code of Corporate Governance 2002 on listed companies. In order to evaluate the impact of the Code of Corporate Governance generally and particularly on cement and leasing sector the questionnaire was developed and dispatched, via mail and email, to thirteen listed companies in cement and leasing sector and one company in insurance sector. A questionnaire was designed in the light of project report published by the Securities and Exchange Commission of Pakistan in September 2003 "Impact Assessment of the Code of Corporate Governance 2002" the Code of Corporate Governance 2002, Listing Regulations, and the Companies Ordinance 1984. The response to the questionnaire was not very encouraging. Despite many reminders and telephonic requests out of thirteen companies only three companies responded to the questionnaire.

The fifth chapter assesses the progress and achievements that occurred in the companies after the implementation of the Code and highlights the key corporate governance issues prevailing in effective implementation of the corporate governance in Pakistan and followed by recommendations and suggestions for the effective implementation of the Code.

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Chapter I

1.1 Introduction:

Corporate Governance is a system through which companies are directed and controlled. It spells out the distribution of rights and responsibilities among the different participants in a company business, such as the board of directors and share holders. Such system provides rules and procedures for making decisions concerning company affairs. The concept of corporate governance gained momentum in the wake of East Asia financial crisis and as a result of scandalous revelations about the corporate practices in the leading US corporations like Enron. Government stock exchanges and business associations across the world have been competing to produce guidelines for the corporate governance.

The Securities and Exchange Commission of Pakistan (SECP) was establish under the Securities and Exchange Commission of Pakistan Act, which was passed and promulgated by the Parliament in 1997, unlike its predecessor the Corporate Law Authority, which was an attached department of the Ministry of Finance, the SECP is an autonomous corporate body. The SECP started operations from January 1999 and as a regulator and custodian of the public interest in year 2002 establish a frame work of good corporate governance. It was the result of joint efforts of the SECP and the Institute of Chartered Accountants of Pakistan (ICAP). As a result of their joint efforts all the listed companies in Pakistan are now required to comply with the provisions of the Code of Corporate Governance. The major purpose of the Code of Corporate Governance is to restructure the board of directors in order to make it accountable to shareholders, to strengthen the internal control system of corporations as well as the internal and external audit system of the listed companies. The Companies Ordinance 1984 has been amended to safeguard the rights of minority shareholder. The Code of Corporate Governance has been extended to listed companies only and non-listing companies are not bound to comply with the Code of Corporate Governance.

1.2 Definition of Corporate Governance:

The term "corporate governance" came into popular use in the 1980 to broadly describe the general principles by which the business and management of companies were directed and controlled. However, there is no universally accepted definition of

"corporate governance". In ordinary senses the term means the manner by which corporations are and should be conducted. A basic definition of corporate governance, which has been widely recognized, is given in Financial Aspects of Corporate Governance (the Cadbury Report) in the following words.

> "Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the directors include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The Board's actions are subject to laws, regulations and the shareholders in general meeting."[1]

This definition of corporate governance has been endorsed in various other discourses on the subject, including the 1998 final report on corporate governance (the Hampel report) by Sir Ronald Hampel.[2] The International Chamber of Commerce in its guide to corporate governance for business managers defines Corporate Governance as:

> "Corporate governance is the relationship between corporate managers, directors and providers of equity, and institutions who save and invest their capital to earn a return. It ensures that the Board of directors is accountable for the pursuit of corporate objectives and that the corporation itself conforms to the law and regulations."[3]

The Organization for Economic Cooperation and Development provides another perspective in its Principles of Corporate Governance by addressing five areas:

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[1] Cadbury, Sir Adrian "The Code of Best Practice", Report of the Committee on the financial aspects of Corporate Governance, 1992. Available at http://rru.worldbank.org/Documents/PapersLinks/1253.pdf. visited on 23 December 2006.

[2] Committee on Corporate Governance, Hampel Committee, Final Report (January 1998) available at www. E:\Corporate Governance in the UK & EU.htm. visited on 23 December 2006

[3] The International Chamber of Commerce guide to corporate governance for business managers, Corporate Governance News Archives available at web side www.iccwbo.org/corpGov/whycorpgov.asp visited on 23 december 2006.

- The rights of shareholders: The corporate governance framework should protect shareholders' rights.

- The equitable treatment of shareholders: The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

- The role of stakeholders: The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financial sound enterprises.

- Disclosure and transparency: The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

- The responsibility of the board: The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The Organization for Economic Co-operation and Development defines corporate governance as:

> "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedure for making decisions on corporate affairs. By doing this, it also provides the structures through

which the company objectives are set, and the means of attaining those objectives and monitoring performance."[4]

The Organization for Economic Co-operation and Development is a unique forum where the governments of about thirty market democracies work together to address the economic and social issues. The Organization for Economic Co-operation and Development published Principles of Corporate Governance for the guidance of the member's countries. The OECD also established Steering Group on Corporate Governance; this Steering Group guides the Organization's work on corporate governance and related corporate affairs issues, including state-owned assets, market integrity, company law, insolvency and privatizations. The above cited definition provided by the OECD is the most authoritative functional definition of corporate governance. It defines corporate governance as the relationship of a company to its shareholders or, more broadly, as its relationship to the society.

Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, with the support of governments and international organizations. As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing requirements may have a coercive effect. Such as disclosure requirements exert a significant pressure on listed companies for compliance. Taken together, all the available definitions of corporate governance lead to a basic idea, which refers to the system by which companies are directed and controlled. It is the process by which company objectives are established, achieved and monitored. Corporate governance is concerned with the relationships and responsibilities between the board, management, shareholders and other relevant stakeholders like employees, suppliers etc within a legal framework. Corporate governance aims to protect shareholder rights, enhance disclosure and transparency, facilitate effective functioning of the board and provide an efficient legal enforcement framework. It makes board members accountable to the shareholders who have the right to receive information on the financial aspect of

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[4] The McKinsey Quarterly, a business journal by Mckinsey & Company. Available at website http://www.mckinsey.com. Visited on 28 December 2006

their investment and exercise power to reward or remove the directors entrusted to run the company.

An important theme of corporate governance deals with the issues of accountability and fiduciary duty of board essentially advocating the implementation of guidelines and mechanisms to ensure good behavior and protect shareholders. The Corporate governance monitors whether outcomes are in accordance with plans and to motivate the organization to be more fully informed in order to maintain or alter organizational activity. It is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. It also regulates the relationships among different participants involved in the formation of corporation.

The principal participants in the company are the shareholders, who provide capital and are the actual owners of the company. The interests of the shareholders are likely to be focused on the value of their shares and dividend payments. The powers of shareholders in large public companies are usually restricted and shareholders have to rely on the board of directors to act in their best interests. The board of directors has the responsibility for giving direction to the company. It delegates most executive powers to the executive management, but reserves some important decision-making powers to itself, such as decisions about raising finance, paying dividends and making major investments. Executive management is also held accountable to the board for their performance.

A board of directors is made up of both executives and non-executives. Executive directors are individuals who combine their role as director with their position within the executive management of the company. Non-executive directors perform the functions of director only, without any executive responsibilities other stakeholders include employees, who have a stake in their company because it provides them with a job and an income. Similarly the lenders and other creditors have an indirect interest in a company, because they expect to be paid what they are owed. The general public is also stakeholders in large companies, because they rely on the goods or services provided by a company to carry on their life. For example, households expect utility companies to provide an uninterrupted supply of water, electricity or gas to their homes, or a reliable telephone connection. Commuters expect a rail company to be under an obligation to provide a convenient and reliable transport service at a reliable price. Corporate

governance is concerned with how powers are shared and exercised by different groups to ensure that the objectives of the company are achieved. It provide the mechanism how the rights and interest of shareholders and other interest groups such as the employees in the corporation are protected and secured , how powers are shared and exercised by the directors and how the holders of power in a company should be held accountable for any illegal act.

1.3 The Significances of Corporate Governance:

Corporate governance is the process and structure through which a company business and affairs are managed by enhancing business prosperity and corporate accountability with the ultimate objective of enhancing shareholder's wealth. It provides the structure through which the objectives of a company are set, and the means of attaining those objectives and monitoring performance are determined. In the broader context the institutions of corporate governance provide a framework within which the social and economic life of countries is conducted. Corporate governance has wider implications and is critical to economic and social well being, firstly in providing the incentives and performance measures to achieve business success, and secondly in providing the accountability and transparency to ensure the equitable distribution of the resulting wealth. It is also settled that countries with high standards of corporate governance practices are more likely to attract international capital as compared to those which do not have such standards.

The study conducted by the McKinsey & Company privately owned US managent counselting company that focuses on solving issues concerning to senior management in large corporations and organizations, found that "Good and proper corporate governance is considered imperative for the establishment of a competitive market. There is empirical evidence to suggest that countries that have implemented good corporate governance measures have generally experienced robust growth of corporate sectors and higher ability to attract capital than those, which have not."[5] The study reveals that institutional investors in emerging markets would be willing to pay as much as 30

[5] The McKinsey Quarterly, a business journal by Mckinsey & Company. Available at website http://www.mckinsey.com. Visited on 28 December 2006

percent more for shares in companies with good governance. Furthermore, it has showed that companies with better corporate governance had higher price-to-book ratios, demonstrating that investors do indeed reward good governance. Further, even if corporations do not rely primarily on foreign sources of capital, adherence to good corporate governance practices will help improve the confidence of domestic investors, may reduce the cost of capital, and ultimately induce more stable sources of financing.

1.4 Corporate Governance in Pakistan:

The nuclear testing and subsequent freezing of foreign currency accounts followed by international sanctions caused a drop in investor confidence in the Pakistani market and led to a flight of capital away from Pakistan. Other macro factors like the military takeover of the government, the 9/11 tragedy, as well as the War on Terrorism did little to bolster investor's faith in Pakistan. In order to address growth concern, and the evolving international standards regarding monitoring and governance, the Securities and Exchange Commission of Pakistan (SECP) introduced the Code of Corporate Governance in 2002, with the aim of managing listed companies through the stock exchanges, in compliance[6]. It is important to mention here that SECP was established under the Securities and Exchange Commission of Pakistan Act 1997, unlike its predecessor the Corporate Law Authority, which was attached to the Ministry of Finance, the SECP is an autonomous body. The SECP started operations from January 1999 and as a regulator and custodian of the public interest in the year 2002 promulgated a code of corporate governance. The Code was formulated by bench marking several international codes and corporate governance reports including the Code of Best Practice of the Cadbury Committee on the Financial Aspects of Corporate Governance published in December 1992 (U.K.), the Report of the Hampel Committee in Corporate Governance published in January 1998 (U.K.), the Recommendations of the King's Report (South Africa), and the Principles of Corporate Governance published by the Organization for Economic Cooperation and Development in 1999. After the

[6] Institutional Shareholders and their Role in Promotion of Corporate Governance in Pakistan by Mahmood, S. and Sharif H Working Paper, Securities and Exchange Commission Pakistan (SECP) available at http://www.secp.gov.pk/dp/Working

introduction of the Code all the listed Companies are required to comply with the provision of The Code of Corporate Governance.

The Code is a first step whereby principles of good governance are envisioned to be systematically implemented in Pakistan, as is mentioned in the project report published by the SECP:

> "The Code of Corporate Governance primarily aims to establish a system whereby a company is directed and controlled by its directors in compliance with the best practices enunciated by the Code so as to safeguard the interests of diversified stakeholders. It proposes to restructure the composition of the board of director's in order to introduce representation by minority shareholders and broad-based representation by executive and non-executive directors. It seeks to achieve the objectives of good corporate governance by recommending strengthening of corporate working, internal control system and external audit requirements. The Code emphasizes openness and transparency in corporate affairs and the decision-making process and requires directors to discharge their fiduciary responsibilities in the larger interest of all stakeholders in a transparent, informed, diligent, and timely manner." [7]

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[7] Manual of Corporate Governance by the Securities and Exchange Commission of Pakistan (SECP) page 10, available at http://www.secp.gov.pk/dp/pdf/manual-CG.pdf. Visited on 28 December 2006

Chapter II

The History of Corporate Ownership and Control in the United States of America

2.1 Introduction:

Businesses around the world need to be able to attract funding from investors in order to expand and grow. Before investors decide to invest their funds in a particular business, they will want to be as sure as they can be that the business is financially sound and will continue to be so in the foreseeable future. Investors, therefore, need to have confidence that the business is being well managed and will continue to be profitable. In order to have this assurance, investors look to the published annual report and accounts of the business and to other information releases that the company might make. They expect that the annual report and accounts will represent a true picture of the company's position.

The annual report and accounts are subject to an annual audit whereby an independent external auditor examines the business records of the certifies that the annual report and accounts have been prepared in accordance with the accepted accounting standards and give a true and fair view of the business activities.

Although the annual report may give a reasonably accurate picture of the business activities and financial position, there are many facts concerning business which are not effectively reflected in the annual reports and accounts. There have been a number of high profile corporate collapses like Enron, WorldCom etc which have arisen despite the fact that the annual reports and accounts seemed fine. These corporate collapses have had an adverse effect on many people such as shareholders, who have seen their financial investment reduced to nothing, employees who have lost their jobs and left the economic impact on the local and international communities in which the failed companies operated.

In essence, corporate collapses affect us all. Why have such collapses occurred? What might be done to prevent such collapses happening again? How can investor confidence be restored? The answers to these questions are all linked to the concept of corporate governance. A lack of effective corporate governance meant that such collapses could

occur; good corporate governance can help prevent such collapses happening again and restore investor confidence.

2.2 Code of Corporate Governance in the United States of America:

In the United States Corporation is governed by a board of directors. The board of directors is elected by shareholders and they are empowered to elect and remove the chief executive officer of corporation who is the head of a corporation. The CEO has broad power to manage the corporation on a daily basis, but needs to get the approval of board of directors for certain major actions, such as hiring immediate subordinates, raising money, acquiring another company by the way of mergers and acquisitions. A merger is a combination of two companies to form a new company, while an acquisition is the purchase of one company by another to form new company, major capital expansions, or other expensive projects. In the United States of America the title of Chief Executive Officer is used for highest authority in the corporation regardless of its actual size while in Common Wealth Countries the term is used mainly in publicly traded corporations, and in privately held companies the term Managing Director is much more common.

Corporate governance issues received great attention in both developed and developing countries during the last decade. The events like the East Asian financial crisis that started in July 1997 in Thailand and affected currencies, stock markets and other asset prices in several Asian countries. In result of these financial crises the Western investors lost confidence in the business of securities in the East Asia and began to pull money out from these developing markets[1]. Similarly the collapses of large US companies such as Enron Corporation which was energy company based in the United States. Enron employed around 21,000 people and was one of the world's leading electricity, natural gas, pulp, paper, and communications company, with claimed revenues of $101 billion in 2000. Enron was named for being "most innovative company in America" for the sixth

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[1] Corporate Governance and Corporate Performance: The case of Asian Financial Crisis by Saravuth Pitiyasak. Thailand law journal September, 20, 2000

consecutive year from 1996 to 2001[2]. The major reason for the collapse of Enron corporation was the misappropriation of companies assets by its high ups by transferring millions of dollars from Enron to their personal accounts and by adopting irregular accounting procedures by not declaring the actual debts and the losses that it suffered and the same were not reported in its financial statements[3].

Similarly, the accounting scandals of WorldCom, an American telecom company which was the United States' second largest long distance phone company after AT&T. In accounting scandles of WorldCom the corporation internal audit department discovered fraud of approximately $3.8 billion in June 2002 during a routine examination of capital expenditures. As a result of this fraud the company filed for Chapter 11 bankruptcy protection of the United States Bankruptcy Code for reorganization of business under the bankruptcy laws and changed its name to MCI. Under the bankruptcy reorganization agreement, the company paid $750 million to the Securities and Exchange Commission in cash and stock in the new MCI, which was intended to be paid to the investor's[4].

As a result of these events the issue of corporate governance in the U.S. received considerable press attention and led to increased shareholders and governmental interest in corporate governance issues. Consequently, these major corporate and accounting scandals resulted in a decline of public trust in accounting and reporting practices of corporations and finally result in passing of the Sarbanes-Oxley Act of 2002 also known as the Public Company Accounting Reform and Investor Protection Act of 2002. After the debacle of Enron and WorldCom it appeared to most people in America that the U.S. corporate governance system was deeply flawed and had to be fixed. At the time, Sarbanes-Oxley was heralded as an essential government response for shoring up investor confidence in the aftermath of the scandals ravishing corporate America and Wall Street. In addition to the actions of Congress and the President, a number of other cops on the beat also stepped up their efforts to detect and root out corporate wrongdoing the Securities and Exchange Commission engaged in wide-scale rulemaking and intensified its enforcement efforts; the Department of Justice began to focus its attention

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[2] Fortune Magazine edition 2001.Avaiable at "http://en.wikipedia.org/wiki/Fortune_(magazine)".Visited on 07 january,2007

[3] Current trends in Corporate Governance and Financial Reporting in United States by Martin Gelter. Harvard International Law Journal. Volume 46.Number 2, Summer 2006.

[4] 15 Largest Corporate Bankruptcies. Avaiable at www.bankruptcydata.com. Visited on 07 january,2007

on corporate fraud; new listing standards were proposed for companies trading on the New York Stock Exchange.[5].

The purpose of the Sarbanes-Oxley Act is to ensure that the corporate scandals that erupted during the last five years do not happen again. The legislation is wide ranging and establishes enhanced standards for all U.S. public company boards, management, and public accounting firms. The Act contains 11 titles, ranging from additional corporate board responsibilities to criminal penalties, and requires the Securities and Exchange Commission (SEC) to implement rulings on requirements to comply with the new law. The most important part of the Act is that it establishes a new quasi-public agency, the Public Company Accounting Oversight Board, which is charged with overseeing, regulating, inspecting, and disciplining accounting firms in their roles as auditors of public companies. The Act also covers issues such as auditor independence, corporate governance and enhanced financial disclosure. The major provisions of Sarbanes-Oxley Act include:

- Creation of the Public Company Accounting Oversight Board (PCAOB)
- A requirement that public companies evaluate and disclose the effectiveness of their internal control.
- Certification of financial reports by chief executive officers and chief financial officers
- Auditor independence, including outright bans on certain types of work for audit clients and pre-certification by the company's audit committee of all other non-audit work
- A requirement that companies listed on stock exchanges have fully independent audit committees that oversee the relationship between the company and its auditor
- Ban on most personal loans to any executive officer or director
- Accelerated reporting of trades by insiders
- Enhanced criminal and civil penalties for violations of securities law

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[5] Lessons Learned: A Brief Retrospective on Sarbanes-Oxley by Troy A. Paredes Washington University Law Review. Vol 85.5 dated April 23, 2007

- Longer maximum jail sentences and larger fines for corporate executives who knowingly and willfully misstate financial statements.[6].

Under Sarbanes-Oxley, two separate certification sections came into effect – one civil and the other criminal. Section 302 (civil provision); and Section 906 (criminal provision). Under Section 302 of the Sarbanes-Oxley Act the signing officers in order to ensure the accurate financial disclosure must certify that they are "responsible for establishing and maintaining internal controls". Under the said section the signing officers are responsible for establishing and maintaining internal controls and "have designed such internal controls to ensure that material information relating to the company and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared." The officers must "have evaluated the effectiveness of the company's internal controls as of a date within 90 days prior to the report" and "have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date[7]. Sarbanes-Oxley Act has imposed new regulatory requirements and measures on publicly traded corporations, directors, accountants. Sarbanes-Oxley created a regulatory body appointed by and under the oversight of the Securities and Exchange Commission, the Public Company Accounting Oversight Board, to enforce a new set of prescriptive regulations governing accounting standards and the activities of accounting firms in auditing and consulting. The Sarbanes-Oxley Act is a federal law and for the first time intervenes in the structure and affairs of the corporation earlier the corporations were governed by the state corporation law. Sarbanes-Oxley strengthened the independence of the board and its auditing function. Public firms are now required to appoint an auditing committee comprised entirely of independent directors and at least one member must be qualified as a financial expert under new Securities and Exchange Commission rules. The audit committee now has direct responsibility for the appointment, compensation, and oversight of the outside auditors, and approval of all auditor services. The auditors must report directly to the

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[6] Public Company Accounting Reform and Investor Protection Act of 2002 of USA. Available at http://en.wikipedia.org/wiki/Sarbanes-Oxley Act. Visited on 12 january,2007

[7] Section 7241 Corporate responsibility for finanical reports, Chapter 98 Sub chapter III of US Code Collection.

board audit committee, which must resolve any disputes between management and the auditors concerning financial reporting. [8].

There have been a lot of changes in laws and regulations after Enron collapse, the main change being the Sarbanes-Oxley Act, which did two things. First, it created the Public Company Accounting Oversight Board (PCAOB), which is in charge of registering and inspecting public accounting firms, and for adopting and modifying audit standards. The registration of accounting firms used to be done on a state level; so in terms of federalism, that was a big change at least as a matter of principle. Second, the PCAOB has the power to bring enforcement actions, which is concurrent with the Securities and Exchange Commission enforcement powers. Which means the PCAOB will pass regulations and, in conjunction with the SEC, have the power to bring enforcement actions. Secondly Act stated that the corporations must have independent audit committees. Again, this is something that historically has been done at the state level[9].

[8] Public Company Accounting Reform and Investor Protection Act of 2002 of USA. Available at http://en.wikipedia.org/wiki/Sarbanes-Oxley_Act. Visited on 12 january,2007

[9] "Corporate Governance and Sarbanes-Oxley Act "Post-Enron' by Professor Thomas Joo of UC Davis School of Law. 6 U.C. Davis Bus. L.J. 24 (2006). Business Law Journal University of California dated May 01, 2006

2.3 The Code of Corporate Governance in the United Kingdom:

There is no generally applicable global corporate governance model. Corporations tend to work within the parameters set out by national laws and regulations and the economic goals and expectations of shareholders. There has, however, been some measure of convergence in corporate governance internationally, largely resulting from the standards required by international investors and capital markets. There have also been initiatives by the World Bank and, more recently, the Organization for Economic Co-operation and Development (OECD) to provide a theoretical and analytical framework for corporate governance.

The regulation of corporate governance in the UK is provided by a number of different rules, regulations and recommendations, namely:

- Common law rules (e.g. directors' fiduciary duties).
- Statute (notably the Companies Act 1985).
- A company's constitutional documents (the memorandum and articles of association).
- The Listing Rules, which apply to all companies that are listed on the Official List
- The Combined Code on Corporate Governance (the provisions of the Code are not mandatory but listed companies are required to include a statement in their annual reports as to whether or not they comply with the Code and give reasons for non-compliance).
- In the context of takeovers of public companies, the City Code on Takeovers and Mergers and the rules of the Takeover Panel apply.
- The Financial Services Authority's Code of Market Conduct (relating to the disclosure and use of confidential and price sensitive information and the creation of a false market)[1].

In the United Kingdom the corporate governance developments began in the late 1980s and early 1990s in the wake of corporate scandals such as Polly Peck and Maxwell. The

[1] Corporate Governance in the UK and USA by Mark J.Roe.The Corporate Governance Law Review. Volume 1 No1

Financial reporting irregularities led to the establishment of the 'Financial Aspects of Corporate Governance Committee' led by Sir Adrian Cadbury. In 1992 such committee published Cadbury Report. Which outlined a number of recommendations regarding the separation of the role of the chief executive and chairman, balanced composition of the board, selection processes for non-executive directors, transparency of financial reporting and the need for good internal controls. The Cadbury Report included a Code of Best Practice and its recommendations were incorporated into the Listing Rules of the London Stock Exchange.

Following the Cadbury Report, a 'Working Group on Internal Control' was established to provide guidance to companies on how to comply with the principles of the Cadbury Code 'reporting on the effectiveness of the company's system of internal control'. This led to the publication of the Rutteman Report in 1994 on 'Internal Control and Financial Reporting'. In 1995, Greenbury Report was published which was the out come of growing public concern about the growth in executive remuneration, especially to departing directors and to the directors of privatized companies. Greenbury Report attempted to develop a code of practice, with special emphasis on accountability and transparency. Much of the report dealt with the role of the remuneration committee and the information about remuneration to be disclosed in the Annual Report.

In January 1996, the Hampel Committee was established to review the extent to which the Cadbury and Greenbury Reports had been implemented and whether the objectives had been achieved. The Hampel Report led to the publication of the Combined Code of Corporate Governance (1998) covering areas relating to structure and operations of the board, directors remuneration, accountability and audit, relations with institutional shareholders, and the responsibilities of institutional shareholders. The 1998 Combined Code applied to all listed companies. It was appended to Listing Rule requiring companies to provide in their annual reports a narrative statement of how they have applied the Code principles and state that they have complied with the Code provisions or, if not, why not and for what period. The Combined Code requires companies to provide a statement in their annual report on how they have applied the provisions of the Code relating to internal control.

This led to the establishment of the Turnbull Committee in 1998 by the Institute of Chartered Accountants in England & Wales (ICAEW) which then resulted in the

Turnbull Guidance, known as Internal Control: Guidance for Directors on the Combined Code published in September 1999. The Turnbull guidance (1999) provides guidance on how to apply the 1998 Code Principle D.2 (Principle C.2 in the 2003 Code), comply with the related provisions the guidance states that it should be followed by boards of listed companies in assessing how the company has applied the Code Principle on internal control; implementing the requirements of Code Provisions on internal control; and reporting on these matters to shareholders in the annual report and accounts.[2]

In March, 2000, Paul Myners was commissioned by the Government to review institutional investment in the UK. The report was published in March 2001, known as 'Institutional Investment in the UK'. The objective of the review was 'to consider whether there were factors distorting the investment decision-making of institutions'. It included suggestions for the improvement of communication between investors and companies and encouraged institutional investors to consider their responsibilities as owners and how they should exercise their rights on behalf of beneficiaries.

In 2002 the Directors' Remuneration Report Regulations were introduced to further strengthen the powers of shareholders in relation to directors' pay. The regulations increase the amount of information shareholders are given on directors' remuneration, certain disclosures, as well as performance graphs. Shareholder may vote in an advisory capacity to approve the directors' remuneration report. In July 2002 the Department of Trade and Industry instigated a review of the Combined Code following a review of company law. The review was led by Derek Higgs and begun in April 2002, with the final report published in January 2003. The main points of Higgs Review were to amend the Combined Code of 1998. The report recommends that non executive directors should

a. Comprise half of the board
b. Be assessed annually
c. Not serve more than two three-year terms on the board
d. Meet as a group at least once a year without the chairman and the executive directors

[2] Combined Code: Principles of Good Governance and Code of Best Practice,(July 2003),page31.Avaiabl at http://www.fsa.gov.uk/pubs/ukla/lr.comcode2003.pdf.Visited on 18 January 2007

e. Conduct a due diligence exercise prior to appointment to satisfy themselves that they can make a positive contribution.[3]

Around the same time the Financial Reporting Council published the Smith Report. An independent group, chaired by Sir Robin Smith, convened in January 2003 to clarify the role and responsibilities of audit committees. The report was published in July 2003. Main recommendations are:

- The audit committee should comprise of at least three members, all independent NEDs
- One audit committee member should have significant, recent, and relevant financial experience
- Suitable and timely training should be provided to committee members.

Recommendations on the role of the committee were to monitor the integrity of the financial statements, review the internal financial control systems, monitor the internal audit function, make recommendations to the board on external auditors, appointment, and monitor and review the performance and independence of external auditors.[4] Both the Higgs and Smith Reports were followed by the Tyson Report on the recruitment and development of non-executive directors commissioned by the Department of Trade and Industry. The recommendations from the Higgs and Smith Reports led to changes in the Combined Code of Corporate Governance published in July 2003. It applies to all companies listed on the primary market of the London Stock Exchange for reporting years commencing on or after 1 November 2003. In 2004, the Financial Reporting Council established the Turnbull Review Group to consider the impact of 'Internal control: Guidance for Directors on the Combined Code' and to determine whether the guidance needed to be updated. Accordingly, Internal Control: Revised Guidance for Directors on the Combined Code was published by the Financial Reporting Council in October 2005.

[3] Available at Department of Trade and Industry website http://www.dti.gov.uk/administration/page13625.html. Visited on 20 january 2007

[4] Available at website http://www.frc.org.uk/corporate/combinedcode.cfm . Visited on 20 january 2007

In July 2005 the Financial Reporting Council announced a review of the implementation of the Code which was published in January 2006. In July 2006 an updated Code superseding and replacing the 2003 Code was published.

2.4 The Code of Corporate Governance in China:

2.4.1 Introduction:

The People's Republic of China was created in 1949 until the late 1970s, The People's Republic of China operated under a strict planned economy system. During the more than 30-year planned economy period, the Communist Party of China under the leadership of Chairman Mao Zedong was the sole ruler and creator of all policies and regulations. The country experienced remarkable economic development in the early stages but eventually witnessed a drastic downturn due to the political turmoil as a result of Cultural Revolution. In 1976 when the Cultural Revolution ended, the new government under the leadership of Deng Xiaoping assumed power; a market economy was introduced as a complement to the existing planned economy. During the 1980s, domestic economic reform officially took off nationwide. The entire 1980s represented an initial experimentation period for the market economy concept in China.

The first real and effective changes came in the early 1990s. In 1991, China established its very first stock exchange in Shanghai, and then in Shenzhen (1992). In 1992, Mr. Deng toured the major southeast coastal cities and reemphasized the government's commitment to the development of a market economy and the establishment of market-based systems in China. Mr. Deng's "Communist market economy theory" was further carried forward by his successor Jiang Zemin and Zhu Rongji in the 1990s. The China market had become a market economy but still certain industries such as banking, telecommunications, and media and publication still remain highly regulated by government[1]

2.4.2 Code of Corporate Governance in China:

According to the Company Law of China, there are three tiers of control over a company's operations: the shareholders' general meeting, the boards of directors and supervisors, and management. The general shareholders' meeting has final say over the key issues of the company, such as approval of the management strategy, the financial budget and key investment plans, and the nomination of the boards of directors and supervisors. The board of directors makes key investment plans and the board of

[1] Corporate Governance in China: Then and Now by Cindy A. Schipani Liu Junhai..Avaiable at web site http://cesifo.oxfordjournals.org/misc/terms.shtml.

supervisors oversees the decision-making process and performance of senior management and directors. The management is responsible for day-to day business.[2]

. The Government of China started working to build the corporate governance system in the country in 1990s but these efforts did not produce any positive results, however, in the beginning of 2001, the discovery of corporate scandals in high profile firms like Guangxia (Yinchuan) Industry Co. Ltd.,Zhengzhou Baiwen Co. Ltd, Sanjiu Pharmaceutical Co. etc by the China Securities Regulatory Commission intensify the need for establishing good corporate governance in the country.[3]

The "Code of Corporate Governance for Listed Companies in China" was issued by the China Securities Regulatory Commission (CSRC) and the State Economic and Trade Commission in January 2002. The legal framework of corporate governance in China is based primarily on the the Certified Accountant Law (issued in 1993), Audit Law (1994), Company Law (1994), People's Bank of China Law (1995), Commercial Bank Law (1995), Securities Law (1998), and Accounting Law (1999).[4]

The code is applicable to all listed companies within China. All the listed companies are required to comply with the code to improve the corporate governance. The Code of Corporate Governance for listed companies expand the rights of shareholder for instance Article 2 of the code states that minority shareholders should have equal status with other shareholders and Article 4 gives shareholders the right to protect their interests through civil litigation and other legal approaches. Article 11 gives institutional investors more weight in the decision making process, including in the nomination of directors. [5]

The code of corporate governance also strengthens the roles of the boards of directors and supervisors. According to Articles 29 and 31, a listed company must establish transparent procedures to select the board of directors, and a listed company in which the

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[2] Corporate governance with Chinese characteristios by steven shi and Drake weisert.China Business Review,Volume29,Number5,September-October2002.

[3] Corporate governance with Chinese characteristics by steven shi and Drake weisert.China Business Review, Volume 29, Number 5, September-October 2002

4. Code of Corporate Governance for Listed Companies in China" issued by the China Securities Regulatory Commission (CSRC) and the State Economic and Trade Commission on, 7 January 2002. www.csrc.gov.cn visited on 27 January 2007.

5. Code of Corporate Governance for Listed Companies in China. Available at www.csrc.gov.cn . visited on 27 January 2007

controlling shareholder owns a stake in excess of 30 percent should adopt a cumulative voting mechanism to ensure the voting interests of minority shareholders. Article 49 requires listed companies to introduce independent directors who do not hold any other positions within the company. Articles 60 and 61 state that members of the board of supervisors must be permitted access to information related to operational status and be allowed to hire independent intermediary agencies for professional consultation, without interference from other company employees Articles 88 and 89 require the listed company to disclose promptly any information that may have a substantial impact on the decision making of shareholders or associated parties.[6]

China Securities Regulatory Commission (CSRC) regulations require that independent directors must spend enough time on the companies they hold directorship; one person cannot hold more than 5 directorship positions concurrently. By June 30, 2002 2414 independent directors had been elected and appointed by shareholders meetings of the 1187 listed companies in China,70% of the companies have at least one accounting professionals to be independent directors.[7]

To conclude this one can say that corporate scandals are always an important factor that drives corporate governance reform throughout the world. When confronted with scandals the government, the markets, as well as the corporations are all forced to react promptly to recover the investors' confidence.UK and USA are pioneers in developing the corporate governance laws and regulations in their respective countries and are generally acknowledged as world leaders in corporate governance reform. In the US, the explosion of corporate scandals like Enron, WorldCom, led to major corporate governance reforms in the United States. The government response to these corporate scandals was the Sarbanes-Oxley Act which was called "the most significant change to American corporate governance since the Securities Act of 1933 and the Securities and Exchange Act of 1934"[8]. The Sarbanes-Oxley introduce many new requirements, it was primarily designed to restore financial confidence in American securities markets.

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6. Code of Corporate Governance for Listed Companies in China. Available at www.csrc.gov.cn . visited on 27 January 2007.
7. Capital Market Reforms in China. The role of corporate governance by Tong Daochi. China Business Review, Volume 29, Number 5, September-October 2002

8. Corporate scandals and corporate governance agenda by Lei Yang. US-China Law Review Apr. 2006, Volume 3, No.4

The Act is intended to protect investors and the public interest through reforms in corporate governance, changes in the relationship between the auditor and client, improved auditor independence, additional management responsibilities for and auditor reporting on the effectiveness of internal control, and enhanced oversight and regulation for auditors of publicly traded companies through creation of the Public Company Accounting Oversight Board.

The regulation of corporate governance in the UK is provided by a number of different rules, regulations and recommendations The UK Combined Code on Corporate Governance provisions are not mandatory but listed companies are required to include a statement in their annual reports as to whether or not they comply with the Code and give reasons for non-compliance. The UK approach to corporate governance is based on "comply or explain" while in the U.S.A corporate governance is determined predominantly by legislation in the form of the Sarbanes-Oxley Act of 2002[9].

China has experienced very high economic growth over the past two decades. It started reforms in financial system to build up an efficient stock market. In 1990 and 1991, China's two stock exchanges the Shanghai and Shenzhen Stock Exchanges were opened. China's stock market has grown to become one of the largest in Asia with market capitalization close to US$ 500 billion. China now boasts of 1400 listed companies, more than 130 securities firms, over 100 000 practitioners, and over 70 million investor accounts[10].In China the most important legal sources of corporate governance rules are the laws passed by the National People's Congress and its Standing Committee. These laws include the Corporate Law of 1993 and the Securities Law of 1998. In addition to legal sources, the memorandum of associations of each corporation plays an active role in designing a corporation's governance structure. The Corporate Law requires corporations to form three statutory and indispensable corporate governing bodies

(1) The shareholders, acting as a body at the general meeting;

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9. Political Determinants of Corporate Governance: Political Context, Corporate Impact, by Mark J.Roe Oxford University Press.

10. Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants by Qiao Liu published on April 24, 2006 Journal of Comparative Economics.

(2) The board of directors; and

(3) The board of supervisors

The Chinese corporate governance structure is similar to the two-tier system of corporate governance in Germany. German corporations are similarly governed by a board of directors and a supervisory board. There are substantial differences, however, between the German and Chinese systems of corporate governance. For example, in China, there is no relation between the board of directors and the board of supervisors, and both directors and supervisors are appointed by, and may be dismissed by, shareholder action. In contrast, the German supervisory board oversees the board of directors, and the members of the board of directors are appointed by, and may be dismissed by, the board of supervisors [11].

10. Corporate Governance in China: Then and Now by Cindy A. Schipani Liu Junhai. Published on June 28, 2007 .China Economic Review.

Chapter III

3.1 Why is Corporate Governance Important?

Corporate governance is commonly referred as a system by which companies are directed and controlled. It is the process by which company objectives are established, achieved and monitored. Corporate governance is concerned with the relationships between the board, management, shareholders and other relevant stakeholders within a legal framework. As stated earlier when a company is incorporated it has some objectives contained in its Memorandum of Association and in order to achieve these goals a company is governed in such a way that moves it towards for the achievement of its objectives.

Although a company exists as a separate legal person, it can own property, enter into contract with other organizations but in reality it is organized by the collective efforts of many different individuals. It is controlled by a board of directors which is elected by shareholders. The board of directors has the responsibility for giving direction to the company. The board of directors appoints chairman and chief executive officer of the company and delegates most executive powers to them, but reserves some decision-making powers to itself, such as decisions about raising finance, paying dividends and making major investments. Executive management like chairman and chief executive officer of the company are also held accountable to the board for their performance.

Corporate governance is a key element in enhancing investor confidence, promoting competitiveness, and ultimately improving economic growth. Corporate governance is a matter of much greater importance for large public companies, where the separation of ownership from management is much wider than small private companies. Public companies raise capital from public by offering shares to them through stock markets. Investors in return need to know that whether their money is reasonably safe. If there be any doubts about the integrity or intentions of the individuals in charge of a company, the value of the company's shares will be affected and the company will be in a difficult position to raise any capital from the investors.

3.2 Corporate Governance Models around the World:

3.2.1 Anglo-American or Shareholder Model of Corporate Governance:

There are number of models of corporate governance that are followed in different parts of the world today. Each model has its own unique set of characteristics that suits the dynamics of the country where it is originated while other countries adopt the one that suits with their socio-economic conditions. The corporate governance models such as the Anglo-Saxon model or the German model are not only implemented and adopted by their countries of origin but by other nations too. Generally the corporate governance regimes are based on either on the shareholder model that is most common in UK and USA and stakeholder model that is common in Germany, France, Netherland and Scandinavian countries.

The UK and US model of corporate governance(Anglo-Saxon model) is for the protection of shareholder, appointment of independent board of directors and focus on solving agency problem arising between the owners of companies (principals) and the boards of directors who have effective control over companies (as agents). The approach used for corporate governance in the UK and the US is to maximize shareholders profit. The supporters of the shareholder model hold that the corporation is an extension of its owners, therefore, responsible only to the shareholders. According to this model of corporate governance the owners have exclusive rights to determine its priorities and profit it may generate because the suppliers of the equity capital i.e. shareholders bear the entire risk of the corporation. The Anglo-American model is also called Shareholder Wealth Maximization Model[1].

3.2.2 Stakeholder Model of Corporate Governance:

In addition to the suppliers of the equity capital i.e. the shareholder there are other groups, which have an interest, attached with the operation of a company. These various groups are called stakeholder, which include labour, management, suppliers etc. The stakeholder model considers the company as a 'social institution' that is responsible and accountable not only to the shareholders but also to the suppliers, customers, employees,

[1] The International Chamber of Commerce guide to corporate governance for business managers, Corporate Governance News Archives available at web side www.iccwbo.org/corpGov/whycorpgov.asp Visited on April 27, 2007).

government and public that are affected by its behavior and performance. The fundamental principle behind the stakeholder model is that shareholders are not the only members who have interest in the performance of company but employees, suppliers, customers also have interest in company's performance. For instance employees have a stake in their company because it provides them with a job as a source of income. They too have expectations about what their company should do for them, and these could be security of employment, attractive pay and suitable working conditions. Similarly, lenders and creditors also have an indirect interest in a company, i.e. they expect to be paid what they are owed. If they deal with the company regularly, or over a long time, they will expect the company to do business with them in accordance with their contractual agreements.

3.3 Codes and Guidelines:

Corporate governance principles and codes have been developed in different countries. In the United States, companies are primarily regulated by the state in which they are incorporated though the federal government also regulates them and, if they are public, by their stock exchange. In other words publicly traded corporations must comply with federal securities laws, the most important of which are the Securities Act of 1933 (1933 Act) and Securities Exchange Act of 1934 (1934 Act). The Sarbanes-Oxley Act of 2002 (SOXA) imposed many new rules on public corporations. Corporations must also comply with the wide variety of federal laws governing employment, environmental protection, food and drug regulation, intellectual property and other areas. In Pakistan companies are incorporated under the Companies Ordinance 1984 and a company whose shares are listed at the Stock Exchange is required to comply with the provisions of the Code of Corporate Governess issued by the Securities and Exchange Commission of Pakistan. Recently the Pakistan Institute of Corporate Governance has been set up as a non-profit organization for promoting the culture of good corporate governance in the country.

In 1999 to assist OECD and non-OECD governments the OECD developed certain Principles of corporate governance, in order to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. The

Principles focus was on publicly traded companies, both financial and non-financial. The OECD remains a proponent of corporate governance principles throughout the world[2]. Similarly, the World Business Council for Sustainable Development (WBCSD) has also done substantial work on corporate governance, particularly on accountability and reporting procedure.

3.4 Corporate Governance in Pakistan:

3.4.1. The Overview of Corporate Governance in Pakistan:

The principal source of corporate governance law in Pakistan is the Code of Corporate Governance, which was first drafted by the Institute of Chartered Accountants of Pakistan in 1998. The Securities and Exchange Commission of Pakistan promulgated the Code in 2002. The Corporate governance is also covered in Companies Ordinance of 1984 and the Banking Companies Ordinance of 1962. Presently, corporate governance primarily falls within the ambit of two entities i.e. the SECP and the State Bank of Pakistan. The SECP, which was formed in 1997 by a legislative action, is the chief enforcer of the Code. The SECP is an independent juristic body that regulates the corporate sector and capital markets. It also regulates non-banking financial institutions. The SECP's autonomy is encouraging as the independence of a regulator is increasingly important for good corporate governance. Most importantly for corporate governance, the SECP enforces the listing requirements for the three stock exchanges of Pakistan: the Karachi Stock Exchange ("KSE"), the Lahore Stock Exchange ("LSE"), and the Islamabad Stock Exchange ("ISE"). Since the provisions of the code are incorporated into the listing requirements of the stock exchanges, the SECP ensures compliance with those requirements. The State Bank of Pakistan is Pakistan's central bank and is responsible for regulating the country's banking and finance sector[3].

The State Bank of Pakistan has the authority to enforce corporate governance guidelines for banks. In addition to complying with the Code, banks must comply with the Prudential Regulations of the State Bank of Pakistan and the Banking Ordinance of 1962.

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[2] OECD Principles of Corporate Governance .Available at http://www.oecd.org/daf/governance/principles.htm

[3] State Bank of Pakistan, http://www.sbp.org.pk/about/index. Visited on April 28, 2007).

3.5 The Legal Aspects of Corporate Governance in Pakistan:

3.5.1. The Corporate Governance Law Regime in Pakistan:

The following is a brief description of the main laws and primary agencies, which regulate corporate governance in Pakistan.

Companies Ordinance, 1984:

This is the main law in Pakistan relating to the governance and regulation of entities incorporated as companies. The Ordinance consolidates and amends the earlier laws relating to this area.

The Ordinance also lays out the powers and functions of the Corporate Law Authority. The Corporate Law Authority is now replaced by the Securities and Exchange Commission of Pakistan (SECP) which inherited all the powers of the Corporate Law Authority under the Ordinance. The Ordinance further establishes the office of the Registrar who supervises the registration of companies and related documents and the corporate disclosure requirements and performs other related tasks.

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Securities and Exchange Ordinance, 1969:

The Ordinance has been promulgated for the stated purpose of providing for the protection of investors, regulation of markets and dealings in securities and related matters and includes important provisions for the prevention of fraud and insider trading.

Securities and Exchange Commission of Pakistan Act, 1997:

The SECP Act has established the SECP for the beneficial regulation of the capital markets and the superintendence and control of corporate entities. The SECP enjoys wide powers in this regard under the SECP Act. The SECP Act also lays out important provisions defining fraudulent and unfair trade practices as well as provisions defining powers of the SECP relating to the protection of minority shareholders, creditors, the regulation of the board of directors of listed companies and the internal management of the SECP.

Code of Corporate Governance, 2002:

The Code was introduced by the SECP in early 2002 for the stated purpose of establishing a framework of good corporate governance whereby a company can be managed in compliance with best practices. The Code has been adopted by all the stock exchanges of the country by way of its incorporation in their respective listing regulations, so that all the listed companies in Pakistan are obliged to comply with the provisions of the Code, according to a timeframe stated in the Code itself. The SECP plans to supervise such compliance by requiring that:

(i) All listed companies are to publish and circulate a statement along with their annual reports to set out the status of their compliance with the best practices of corporate governance;

(ii) All listed companies are to ensure that the statement of compliance with the best practices of corporate governance is reviewed and certified by statutory auditors; and

(iii) Where the SECP is satisfied that it is not practicable to comply with any of the provisions of the corporate governance in a particular case, it may, for reasons to be recorded, relax the same subject to such conditions as it may deem fit.

3.6 Security and Exchange Commission of Pakistan Recent Corporate Governance Reform Efforts:

A Code for Corporate Governance was introduced by the SECP in early 2002 for the purpose of establishing a framework of good corporate governance, whereby a listed company can be managed in compliance with international best practices. It is the result of joint efforts of the SECP and the Institute of Chartered Accountants of Pakistan (ICAP). The Code has been adopted by all the stock exchanges of the country by way of its incorporation in their respective listing regulations. As a result all listed companies in Pakistan are now required to comply with the provisions of the Code. The introduction of the Code has been followed by amendments in the Companies Ordinance 1984, which are aimed to strengthen corporate governance in Pakistan. The major thrust of the Code is to restructure the board of directors in order to make it accountable to all shareholders.

It also aims at the strengthening of the internal control systems of corporations and to strengthen internal and external audit requirements of listed companies. In addition, the Companies Ordinance 1984 has been amended to protect minority shareholder rights. However, at present the requirements suggested by the Code have not been extended to non-listed companies nor have they been enacted as part of the Companies Ordinance. The important provisions of the Code of Corporate Governance and the Companies Ordinance 1984 related to strengthening corporate governance in Pakistan are as following:

A. Strengthening the Board of Directors (BOD):

The Code provides that all the listed companies must have representation of independent director in their board to make the same more effective; code further attaches special importance to the role of Non-Executive Director (NEDs). It visualizes the Non-Executive Directors as performing two significant functions, namely

1. A careful independent review of the performance of the Board and of the Chief Executive; and

2. Taking the lead where potential conflicts of interest arise. In effect the Code is using NEDs to provide a check in situations when the specific interests of the executive management and the wider interests of minority shareholders divergence e.g. over takeovers or director's pay.

Clause (i-a) of the Code takes some progressive and highly significant steps in this direction by encouraging listed companies to ensure effective representation of independent NEDs, including those representing minority interests, on their Boards of Directors. Additionally, Clause (i-b) of the Code recommends that the Boards of Directors of listed companies include at least one NED representing institutional equity interest of a banking company, Development Financial Institution, Non-Banking Financial Institutions (including a modaraba, leasing company or investment bank), mutual funds and insurance companies. It is further recommended by Clause (i-c), that for listed companies, the executive directors (working or whole-time directors) as a group should not constitute more than 75% of the elected directors (including the Chief

Executive)[4]. Therefore, the Code takes a number of important steps that bring corporate governance regulations in Pakistan in line with international best practice. It is also important to point out that the introduction of the concept of NEDs in Pakistan's corporate governance regulations is an important addition brought about by the code, as the Companies Ordinance (1984) have no such provision. However, the Code does not require companies to appoint Non-Executive Directors; it merely recommends this as a practice.

B. The Role of the Chairman and the CEO:

The Code makes an attempt to give some definite shape and direction to the role of the Chairman of the board of directors in Pakistan's Corporate Governance environment. Clause (ix) lays down that the Chairman of a listed company is to be preferably elected from among the Non-Executive Directors. It also requires that the board of directors is to clearly define the respective roles and responsibilities of the Chairman and CEO, whether or not these offices are held by separate individuals or the same individual Likewise, Clause-ix requires the Board of Directors to clearly define the role and responsibilities of the Chief Executive. It further requires vide Clause viii-e that the appointment, remuneration and other terms and conditions of employment of the CEO and other executive directors should be determined and approved by the board of directors. This provision is expected to increase the accountability of management to the BODs[5].

In the matter of General Tyre and Rubber Company of Pakistan the company fails to circulate to the shareholders abstract relating to increase in Chief Executives remuneration. Enforcement Department of the Security Exchange Commission of Pakistan while examining the financial statement of the company for the relevant year noticed that the remuneration of Chief Executives has been increased without intimation to the shareholders as per requirement of the Companies Ordinance 1984. The

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[4] Code of Corporate Governance Published by The Securities and Exchange Commission of Pakistan,(Islamabad,2002) page 1-2

5 Code of Corporate Governance Published by The Securities and Exchange Commission of Pakistan, (Islamabad, 2002) page 04

Enforcement Department imposed fine of Rs 5000/= each on the company and its secretary[6].

The Companies Ordinance 1984 does not lay down a well-defined and distinct role for both the Chairman of the BODs and the office of the CEO. This essentially means that two important Corporate Offices had not received any detailed attention in the Companies Ordinance. In fact, Section 160 (3) of the Companies Ordinance 1984 proposes an extremely vague definition of the Chairman's role,

> "The Chairman of the Board of Directors, if any, shall preside as Chairman at every general meeting of the company, but if there is no such Chairman, or if at any meeting he is not present within fifteen minutes after the time appointed for holding the meeting, or is unwilling to act as Chairman, any one of the directors present may be elected to be Chairman, and if none of the directors are present or are unwilling to act as Chairman, the members present shall choose one of their numbers to be Chairman."[7]

At present neither the Code nor the Companies Ordinance specifically precludes the possibility of the same person holding the office of the Chairman and the CEO. This means that a person holding the office of the Chairman at the same time hold the office of CEO as well.

C. Strengthening the Decision Making at the Level of the BODs:

The Code in order to strengthening the decision making at the Level of the board of directors has fixed the tenure of office of the directors; and had provided the list of significant issues that should be put before the BODs for consideration and decision. Again Clause (xi) of the Code says that the board of directors of a listed company is to meet at least once in every quarter of the financial year. This provision has been made part of the Companies Ordinance through an amendment to Section 193. Earlier the directors of the public were required to meet twice in a year[8].

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6 In the matter of General tyre and Rubber Company of Pakistan Limited. 2006 CLD 1060

7 The Companies Ordinance 1984, section 160

8 The Companies Ordinance 1984, section 193

Clause (VI) affirms the existing tenure limit in the Companies Ordinance (Section 180) by stating that the tenure of the office of directors is to be three years. This provides a good balance in allowing directors to develop a strategic long-term vision. Further, the Code (Clause xiii) proposes a list of significant issues which should be put before the Board f Directors for information, consideration and decision, in order to strengthen and formalize the corporate decision making process, previously there was no requirement for the BOD to specifically perform these functions.[9]

D. Statement of Ethics and Business Practices:

In order to strengthen accountability at the level of directors the Code (Clause viii-a) requires that every listed company shall prepare and circulate a 'Statement of Ethics and Business Practices' on an annual basis. The objective of publishing such statement is to establish a standard of conduct for directors and employees by requiring each of them to sign the statement and acknowledge his (her) acceptance and understanding of the standard of conduct. Again the Code has taken a step that is not provided in the provisions of the Companies Ordinance 1984.

E. Disclosure by Directors and Management:

The Code has come up with the following important disclosure requirements and limitations on the actions of directors and management that will help increase their accountability to external investors:

1. For listed companies, the Code (Clause xxvi) has come up with the further requirement that any director, chief executive, executive or their spouses selling, buying or taking any position, whether directly or indirectly, in the shares of a listed company of which s/he is director, chief executive or executive, as the case may be, is to immediately notify the Company Secretary of such intentions and deliver a written record of the price, number of shares, form of share certificates and nature of the transaction. Such notice has to be presented by the Company Secretary at the meeting of the board of directors immediately subsequent to such transaction

[9] Code of Corporate Governance Published by The Securities and Exchange Commission of Pakistan,(Islamabad,2002) page 05

2. Clause xxvi requires that each company shall determine a closed period prior to the announcement of the interim/final results and any business decision, which may materially affect the market price of its shares. It also requires that no director, chief executive or executive shall, directly or indirectly, deal in the shares of that company in any manner during the closed period[10].

The Companies Ordinance 1984 also stipulates disclosure requirements and limitations on the part of directors, which help further the accountability of directors to shareholders. The following are the main requirements found in the Companies Ordinance

(a) Directors and other officers are obliged by Sections 214 and 215 of the Companies Ordinance 1984 respectively, to disclose the nature of their direct or indirect concerns or interests in any contract or arrangement entered into or to be entered into by or on behalf of the company.

(b) Section 216 of the Companies Ordinance precludes discussion of or voting on any contract or arrangement in which the said director is, directly or indirectly, concerned or interested.

(c) A violation of the above sections can (apart from a financial penalty) lead to a court decision, declaring a director as lacking fiduciary behavior, under Section 217 of the Ordinance

(d) Section 218 of the Ordinance mandates disclosure to members of a director's interest in contracts; appointing the chief executive, managing agent, whole-time director or secretary. Again, non-compliance leads to a fine.

(e) Section 203 of the Ordinance requires that the Chief Executive cannot engage, directly or indirectly, in a business competing with the company's business. The Section further requires that the Chief Executive disclose to the company in writing, the nature of such business and his interest therein.

The Karachi High Court in the Pfizer Laboratories Ltd Case held that the Chief Executive of a public company shall not directly or indirectly engage himself in any

[10] Code of Corporate Governance Published by The Securities and Exchange Commission of Pakistan,(Islamabad,2002)page 08

business, which is of the same nature, and directly compete with the business carried on by the company of which he is Chief Executive or by subsidiary of such Company[11].

The Karachi High Court in another case title Muhammad Bakhsh & Sons Limited Versus Azhar Wali Muhammad while elaborating the relationship between director and company held that nature of relationship being a fiduciary between a director and company, such director was always to act in good faith vis-à-vis, the company. Directors could be treated as trustees of money which came into their hands and on proof of misapplication or misuse thereof, would be held liable to make good that money[12].

In Ramaswamy Iyer Versus Bramayya & Co case the Madras High Court observed that the directors of a company are trustees for the company and with reference to their powers of applying funds of the company and for misuse of power they could be rendered liable as trustee and on their death the cause of action survives against their legal representatives[13].

F. Disclosure with Regard to the Associated Companies:

Section 208 of the Companies Ordinance (1984) provides that, "A company shall not make any investment in any of its associated Companies or associated undertakings except under the authority of a special resolution..."[14]. The section has also stipulated strong penalties in the event of non-compliance with the law.

G. Protection of Minority Shareholder:

The shareholder rights, specified in the company laws, include the right to participate and vote in Annual General Meetings (AGMs) and Extraordinary General Meetings, including electing members of the board and participating in making the key decisions, such as amendments to the articles of association.

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[11] Pfizer Laboratories Ltd Case.2003 CLD 1209
[12] Muhammad Bakhsh & Sons Limited versus Azhar Wali Muhammad.1986 MLD 1870
[13] Ramaswamy Iyer Versus Bramayya & Co.1966 Companies Law journal 107
[14] The Companies Ordinance 1984, section 208

H. Right to Attend and Call Annual General Meeting (AGMs) and Extraordinary General Meeting:

These rights described in the Companies Ordinance 1984 appear to be in line with the modern Anglo-Saxon company law. Section 158 of the Companies Ordinance mandates that every company is to hold, in addition to any other meetings, a general meeting, as its annual general meeting, within 18 months of its incorporation and thereafter once at least in every calendar year. The AGM has to be held within a period of six months following the close of the company's financial year and not more than 15 months after the holding of its last preceding annual general meeting. For the listed companies, the SECP, and for other companies, the Registrar may for any special reason extend the time within which any annual meeting is to be held. Holding of annual general meeting is mandatory and its failure results in imposition of penalties.

In Mian Muhammad Ilyas Mehraj and Others versus Executive Director (Company Law Division) matter where the Company was required to hold its annual general meeting for the year ending 30-9-2004 on or before 31-1-2005, having failed to hold said meeting. Enforcement Department of the Security Exchange Commission issued show-cause notice to the Company and its directors including the chief executive for not holding meeting within the time prescribed undersection.158 of Companies Ordinance, 1984. Management of the company in response to show-cause notice took up the plea that since certain individuals had acquired substantial number of shares of the Company in violation of Listed Companies (Substantial Acquisition of Voting Shares of Takeovers) Ordinance, 2002, and were intending to contest the election of directors, to be held in 2004. It was incumbent upon the management to postpone said annual general meeting. The Commission held that election of directors being just one of the agenda in the annual general meeting, same should not have been made ground for not holding annual general meeting for two consecutive years. Election of directors could have been held subsequently in an extraordinary general meeting called specifically for that purpose. By that way neither the rights of the shareholders would have been violated nor would the management have contravened the statutory requirement of holding annual general meeting. The company should not have postponed general meeting just because one of the agenda items of the meeting could not have been carried out. By not holding annual general meeting, management of company had infringed shareholders' right to be

informed of the company's affairs and the struggle raging between two groups of shareholders for the management of the company. Violation of law by the management in not holding the annual general meeting within the prescribed time was established. Penalties had rightly been imposed on petitioners, in circumstances[15].

Similarly in the matter of Quality Steel Works Limited versus Executive Director (Company Law Division) the Company failed to hold annual general meeting within the prescribed period, a notice was issued on the directors including chief executive of company calling upon them to show cause as to why penalties as provided under subsection (4) of section 158 of the Companies Ordinance, 1984 may not be imposed on them. The directors, who admitted said default, had contended that annual general meeting could not be held during relevant period because operation of the company remained suspended and no staff was available to prepare the accounts and that management of the company remained involved in litigation with the Banks for settlement of loans. Suspension of operation of company or its non-functioning was not a cogent excuse for non-holding of annual general meeting and non-circulation of accounts to the shareholders. The Appellate Forum held that Protection of the investors/shareholders was one of the primary objectives of Companies Ordinance, 1984 as they provide seed for capital formation. If the interest of said investors/shareholders was protected, they would save and invest more and the interest of investors/shareholders was protected by transmission of timely, adequate and meaningful information to them and it was the annual and interim accounts, which could provide information to the investors/shareholders about the affairs of the company. Annual general meeting was a forum where investors/shareholders could freely discuss, speak and vote on important matters concerning approval of accounts, appointment of auditors, election of Directors etc. Default regarding holding of annual general meeting for relevant year stood established, however, instead of imposing maximum fine of Rs.50, 000 on the company and every director, penalty of Rs.30, 000 was imposed on the chief executive and each of the directors of the company[16].

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[15] Mian Muhammad Ilyas Mehraj and Others versus Executive Director (Company Law Division) 2007 CLD 297

[16] Quality Steel Works Limited versus Executive Director (Company Law Division). 2007 CLD 1116

I. Extraordinary General Meetings:

Section 159 of the Ordinance allows the directors to call an extraordinary general meeting to consider any matter that requires the approval of the company in a general meeting. However, at least one-tenth of the votes are required to call an extraordinary general meeting. The requisitions, or a majority of them in value, may themselves call a meeting, if the directors do not proceed to call the meeting within 21 days from the date of requisition. Any default entails penalties[17].

J. Power of the Registrar to call Meetings:

Section 170 of the Ordinance gives the Registrar the power to call any annual general meeting or extraordinary general meeting, if there has been a default in the holding of any such meetings. The meeting can be called either on the motion of the registrar or on the application of any director or member of the company. Furthermore, there is a penalty for any default in complying with the Registrar's directions[18].

K. Minority Shareholders Right to Pass Special Resolutions:

Section 164(2) of the Ordinance gives members with at least 10% voting power in the company the right to give notice of a resolution, which they want to consider at a general meeting. Similarly, Section 167(c) and (d) of the Ordinance require the Chairman to order a poll upon the demand of, any member or members present in person or by proxy having at least one-tenth of the total voting power in respect of the resolution However, Section 28 of the Ordinance requires a special resolution passed by three-fourths of the members of a company for it to alter any of its articles of association. In the event that the alteration affects the substantive rights or liabilities of a class of members then at least three-fourths of this class needs to vote in favor of the alteration, for it to take effect[19].

L. Voting Rules:

Section 160(4) of the Ordinance allows every member to have votes proportionate to the paid-up value of the shares or other securities carrying voting rights held by him

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[17] The Companies Ordinance 1984, section 159
[18] The Companies Ordinance 1984, section 170
[19] The Companies Ordinance 1984, section 164(2) & section 167

according to the entitlement of the class of such shares or securities, as the case may be. Similarly, Section 160(5) of the Ordinance states that no member carrying shares or other securities carrying voting rights shall not be debarred from casting his vote, nor shall anything contained in the articles have the effect of so debarring him.

The Pakistani law allows for the proxy voting thereby strengthening the rights of minority shareholders. Section 160(7) of the Ordinance says that on a poll, votes may be given either personally or by proxy.

The Lahore High Court in case title Shah Rafi Alam Versus Lahore Race Club held that the proxies are the agents of the shareholders and vote can be given either personally or by proxy and such right expressly conferred on member under section 161(1) of the Companies Ordinance1984. Any provision contained in the memorandum and articles, agreement or resolution to the extent of its repugnancy to the provisions of the Ordinance would be void. Section 161 of the Ordinance is a special provision and general provisions cannot override the special provisions applicable to a particular class of companies[20].

The Ordinance also appears to allow a form of cumulative voting. Section 178(5)(b) says that a member may give all his votes to a single candidate or divide them between more than one of the candidates in such manner as he may choose Again, this provision goes some way in strengthening minority shareholder rights[21].

M. Right to Claim Dividend:

Section 248 of the Ordinance mandates that no dividend can exceed the amount recommended by the directors. The Karachi High Court in case title Aminuddin Versus Azad Friends and company held that declaration of dividends is in the discretion of the Board of Directors[22]. Further Section 251 of the Ordinance requires that when a dividend has been declared, it has to be paid within forty-five days of the declaration. A default regarding this provision may expos the CEO for imprisonment of up to two years and fine up to a million rupees. The Pakistani law makes the BOD the relevant forum for

[20] Shah Rafi Alam versus Lahore Race Club. 2004 CLD 373(a)
[21] The Companies Ordinance 1984, section 178(5)(b)
[22] Aminuddin Versus Azad Friends and company. 2002 CLD 1519

deciding on dividends[23].Indian Supreme Court in a case title Bacha F. Guzdar Versus CIT held that once a dividend is declared it becomes a statutory debt from the company to its shareholders[24].

N. Judicial Recourse Available to Minority Shareholders:

Section 108 of the Ordinance provides that if ten percent or more of the class of shareholders have been aggrieved by any such variation of their rights, they may, within thirty days of the date of the resolution, varying their rights; apply to the Court for an order cancelling the resolution. The Court is thus entrusted with the task of ensuring that these shareholders are not the victims of any unfair prejudice[25].

O. Minority Shareholder Rights Related to Transfer of Shares:

Section 289 of the Ordinance provides for minority shareholder protection in the event of transfer of shares between companies. It binds the transferring company to acquire the shares of dissenting shareholders on the same terms as the ones on which shares of the approving shareholders are being acquired. It also states that for a transfer of shares between companies to take place requires the approval of at least 9/10th of the holders of the company's shares in terms of value. Finally, Section 86 of the Ordinance states that where directors decide to increase capital by issuance of further shares, such shares are to be issued to each existing member strictly in proportion to his present shareholding, irrespective of the class of shares held[26]. Many of these substantive regulatory and legal provisions that strengthen the board of director structure and give effective protection to minority shareholders are compatible with the standards provided by the Anglo-Saxon legal Framework and the Principles of Corporate Governance by the OECD.

Under Pakistani law the protection of the rights of the shareholders and creditors falls under three heads namely:

1. Statutory Rights and Best Practice Guidelines
2. Protection through the Regulatory Agencies
3. Protection through the Courts

[23] The Companies Ordinance 1984, section 251
[24] Bacha F. Guzdar Versus CIT. AIR 1955 Supreme Court 74
[25] The Companies Ordinance 1984, section 108
[26] The Companies Ordinance 1984, section 289

1. Statutory Rights and Best Practice Guidelines:

These are rights, which are already incorporated in the Ordinance and other related laws. For instance the shareholders rights to have access to information and to know to how the company is being run. In other words these are shareholder and creditors rights to information, which are embodied in Ordinance and other related laws.

1.1 The Role of Chairman:

Section 160 of the Ordinance deals with provisions as to 'general meetings and votes'. Clause (3) of the section says "The chairman of the board of directors, if any, shall preside over as chairman at every general meeting of the company, but if there is no such chairman, or if at any meeting he is not present within fifteen minutes after the time appointed for holding the meeting, or is unwilling to act as chairman, any one of the directors present may be elected to be chairman, and if none of the directors are present or are unwilling to act as chairman, the members present shall choose one of their numbers to be chairman".

The Ordinance does not specifically preclude the possibility of the same person holding the office of Chairman and Chief Executive, because there is no provision in the Ordinance, which prohibits a person from holding the office of the chairman and the CEO at the same time. The Code, however, lays down that the chairman of a listed company is to be preferably elected from among the non-executive directors of the listed company and that the board of directors is to clearly define the respective roles and responsibilities of the Chairman and the Chief Executive, whether or not these offices are held by separate individuals or the same individual. The Code makes further attempts to formalize the role of chairman by requiring that, the Chairman, if present, preside over the meetings of board of directors which are required to meet at least once in every quarter of a financial year and the chairman ensure that the minutes of meetings of the board of directors are appropriately recorded and circulated.

1.2 The Role of Chief Executive:

Section 203 of the Ordinance requires that the Chief Executive cannot engage, directly or indirectly, in a business competing with the company's business. The section further

requires that the Chief Executive shall disclose to the company, in writing, the nature of such business and the interest therein. The mechanism for removing a Chief Executive who entrenches himself against the wishes of the directors is provided under Section 202 of the Ordinance which allows such a removal through a 'special resolution' passed by at least three fourths of the total number of directors at the time. The Code also requires that the appointment, remuneration and other terms and conditions of the employment of Chief Executive and other executive directors of listed companies are to be determined and approved by the board of directors.

1.3The Quorum and Frequency of the Board Meetings:

Section 193 of the Ordinance lays down the quorum for a meeting of the board of directors of a listed company as not less than one third of their number or four, whichever is greater. The directors of a public company are required to meet once in a quarter. In case of any default regarding the above there are financial penalties for the Chairman and the directors.

1.4 The Decision Making Process of the Board:

The Ordinance and related laws do not provide any provision regarding the board decision making powers. However, the Code contains some important provisions to formalize and structure the decision making process of the board. The Code requires that significant issues be placed before the board for their information, consideration and decision of the directors of listed companies. The Code attaches an exhaustive list for this purpose provided in clause xvii of the code.

1.6 System of Sound Internal Control:

The Code requires that the boards of directors of listed companies shall establish a system for sound internal control, which is effectively implemented at all levels within the company. It also lays out certain areas of decisions which should be taken by the boards of directors and documented through board resolutions, which include investment and disinvestments of funds, nature and limit of loans advanced by the company, write-off of bad debts etc, write-off of inventories, and compromise/waiver of suits.

1.7 Statement of Ethics and Business Practices:

The Ordinance does not require the preparation of any such statement but once again the Code has tried to take an initiative in the area by requiring that every listed company is to prepare and circulate a 'Statement of Ethics and Business Practices' on an annual basis to establish a standard of conduct for directors and employees, which statement is to be signed by each director and employee in acknowledgement of his acceptance and understanding of the standard of conduct.

1.8 Restrictions on the Contribution to Political Parties:

Section 197 of the Ordinance prohibits a company from contributing any amount to any political party or for any political purpose to any individual or body, or else face penalties. Section 197-A of the Ordinance prohibits the distribution of gifts by a Company in any form to its members at its meetings.

1.9 Board's Responsibility towards Prevention of Fraud:

The prime responsibility for the prevention and detection of fraud and other illegal acts is that of the board, as part of its fiduciary responsibility for protecting the assets of the company. Directors are responsible for maintaining a system of internal controls for the minimization of the risk of fraud. Under the Ordinance and related laws there is no mandatory mechanism, which the directors are required to employ for the prevention of the commission of fraud. However, the Ordinance does contain some specific penalties for fraudulent acts, which are as follows.

1.9.1 Penalty for Fraudulently Inducing Persons to Invest Money:

Section 66 of the Ordinance carries a penalty of up to three years imprisonment and up to a fine of RS. 20,000 for anyone making any statement, promise or forecast which is untrue to induce other persons to acquire or dispose of shares. Section 153 lays down imprisonment of up to one year as a penalty for fraudulent entries or omissions from register of company.

1.9.2 Prevention of Insider Trading:

The main objective of the Insider Trading Guidelines is to curb' insider trading' in the security markets. The Insider Trading Guidelines prohibit the use of 'unpublished price sensitive information' by any person who at any time during the preceding six months has been associated with the concerned company either on his own or on behalf of someone else by dealing in such securities, disclosing such information to someone else or aiding him to deal in securities on the basis of such information. The Insider Trading Guidelines define 'unpublished price sensitive information' as the information concerning a company, which is not generally known or published by that company and is likely to materially affect the price of its securities.

Any person found guilty of 'insider trading' is liable to penal action under section 15-B of the Securities and Exchange Ordinance, 1969. The Insider Trading Guidelines further provide that a person, dealing with the securities on the basis of unpublished price sensitive information shall be liable to compensate the person/entity suffering any loss or damage as a result of such transaction. If the issuer of a security fails to obtain prosecution of an action commenced against a person guilty of insider trading then the SECP or the person affected by such insider trading may obtain sanction of the court to enforce the liability.

Under Para 7, the SECP may, on an application or suo moto, undertake to investigate into the books of accounts of an insider to check insider trading. The SECP may appoint an enquiry officer, who may be an auditor, for carrying out such investigation and the insider shall be under obligation to allow such officer to have access to his books and records, etc. Before taking any action on the basis of any enquiry, the SECP is bound to give the insider an opportunity of being heard and also to consider the explanations, if any, given by him. After receiving such explanation the SECP may, in order to protect the interest of investors restrain the insider from dealing in securities in any particular manner, or prohibit the insider from disposing of any of the securities acquired in violation of these regulations, or restrain the insider from communicating or providing counsel to any person in relation to dealing with the securities.

In In Diamond Versus Oreamuno case where the directors sold their shares before the publishing half yearly statements and the market went down after the publication because the accounts were not according to expectations the court held that they were liable to hand over profits to the company[27].

1.10 Board Remuneration:

Shareholders are entitled to a full and clear statement of a director's present and future benefits for their service and how they have been determined. Boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors and chaired by a non-executive directors, to recommend to the board the remuneration of the executive directors in all its forms executive directors should take no part in the decisions on their own remuneration. Shareholders require that the remuneration of directors should be both fair and competitive. Section 191 of the Ordinance says that the remuneration of a director, for performing extra services, including holding the office of the chairman, shall be determined by the directors or the company in general meeting in accordance with the provisions in the company's articles. The remuneration to be paid to any director for attending the meetings of the board of directors or a committee shall not exceed the scale approved by the company or the directors, as the case may be, in accordance with the provisions of the articles. The process of setting remuneration, disclosure of such information and the appointment of enumeration committees are not mentioned in the Ordinance and other relevant laws.[28]

1.11 Qualifications and Eligibility to Act as a Director:

Section 187 of the Ordinance lays down some basic requirements for the eligibility of a person to be elected as a director. These requirements pertain to requisite age, soundness of mind, solvency, absence of any conviction by a court for an offence involving moral turpitude, absence of an earlier debar from holding such office under the Ordinance .

The Code supplements these basic eligibility criteria with some additional mandatory requirements for listed companies, non-observance of which lead to disqualification of an ineligible nominee or director. These requirements are briefly as follows: In order to be eligible to become a director, a person (i) have his name present on the register of

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[27] Diamond Versus Oreamuno 1969.24 NY 2d 494
[28] The Company ordinance Section 191

National Tax Payers, except where such person is a non-resident; and (ii) such a person should have no prior conviction by a court as a defaulter in payment of any loan. Additionally, the Code says that listed companies are to endeavor that no person is elected or nominated as director if he or his spouse are engaged in the business of stock exchange brokerage unless specifically exempted by the SECP.

1.12 Level and nature of checks on the Directors' powers:

Directors are mandated by Sections 214 and 215 of the Ordinance to disclose the nature of their direct or indirect concerns or interests in any contract or arrangement entered into or to be entered into by or on behalf of the company. Section 216 of the Ordinance precludes discussion of or voting on any contract or arrangement in which the said director is, directly or indirectly, concerned or interested. A violation of the above sections can (apart from a financial penalty) lead to a court declaring a director as lacking fiduciary behavior, under Section 217 of the Ordinance. There is also provision for disclosure of a director's interest in contracts appointing chief executive, managing agent, full-time director or secretary, with non-compliance leading to a fine.

In the matter of Messrs Netsol Technologies Limited the company provided loans to directors in contravention to the provisions of the Ordinance. On examination of annual accounts of the Company for relevant year showed that Company had provided loans to its Directors, without taking approval of Commission for making said loans to Directors; and that no particulars had been filed with Registrar of Companies in that respect. Enforcement Department, in circumstances apprehended violations of statutory provisions of section195 of Companies Ordinance, 1984. Show-cause notice was issued under sections 195 & 476 of Companies Ordinance, 1984 to Chief Executive and Directors of the Company. The Appellant bench held that Company had breached the mandatory requirements of section 195 of Companies Ordinance, 1984, however due to minor nature of default and keeping in view the fact that Company was a newly listed, lenient view of the matter was taken and instead of imposing any fine, invoking powers contained in section 473 of Companies Ordinance, 1984, Company was directed to file particulars of loans provided to directors with the Registrar and send a copy of the same

with the directions that Company would, in future comply with provisions of Companies Ordinance, 1984[29].

In addition to the provisions of the Ordinance, the Code has come up with some important disclosure. For listed companies, the Code has come up with some further requirement that any director, chief executive, executive or their spouses selling, buying or taking any position, whether directly or indirectly, in the shares of a listed company of which he is director, chief executive or executive, as the case may be, is to immediately notify the Company Secretary of such intentions and deliver a written record of the price, number of shares, form of share certificates and nature of the transaction. Such notice will be presented by the company secretary at the meeting of the board of directors immediately after such transaction. There is also a further provision requiring that each company determine a closed period prior to the announcement of interim/final results and any business decision, which may materially affect the market price of its shares, and no director, chief executive or executive shall, directly or indirectly, deal in the shares of that company in any manner during the closed period.

1.13 Training of Directors:

It is highly desirable that all directors should undertake some form of internal or external training; this is particularly important for directors, whether executive or non-executive, with no previous board experience. The Ordinance and the related laws do not mandate that companies ensure any such compulsory training. The Code, however, has addressed this issue by requiring that all listed companies are to make appropriate arrangements to carry out orientation courses for their directors to acquaint them with their duties and responsibilities and to enable them to manage the affairs of the company on behalf of shareholders.

1.14 Appointment of the Company Secretary and the CFO:

The Code takes initiative in this area by formalizing the appointment and qualification requirements of both the Company Secretary as well as the Chief Financial Officer (CFO), two offices, which it considers important and which should be occupied by separate individuals. The Code requires that the Company Secretary and the CFO be

[29]Messrs Netsol Technologies Limited versus Executive Director (Company Law Division) 2006 CLD 684

appointed and their remuneration, terms and conditions of employment as well as removal be determined by the Chief Executive with the approval of the board of directors. Both the CFO and the Company Secretary are required by the Code to attend meetings of the board of directors. The Code requires that a Company Secretary be (a) a member of a recognized body of professional accountants; or (b) a member of a recognized body of corporate/chartered secretaries; or (c) a lawyer; or (d) a graduate from a recognized university or equivalent, having at least five years experience of handling corporate affairs of a listed public company or corporation. The Company Secretary is required to play an additional specific and important role, which is that in the event the director of a listed company is of the view that his dissenting note has not been satisfactorily recorded in the minutes of a meeting of the board of directors, he may refer it to the company secretary, requiring that the note be appended to such minutes failing which he may file an objection with the SECP. As to the qualifications of the CFO, the Code requires that he be either, (a) a member of a recognized body of professional accountants; or (b) a graduate from a recognized university or equivalent, having at least five years experience in handling financial or corporate affairs of a listed public company or a bank or a financial institution.

1.15 Financial Reporting and Disclosure Requirements:

Section 233 of the Ordinance obliges a director to present a balance sheet and a profit and loss account at every annual general meeting. These reports are to be accompanied by a proper auditor's report and a director's report which is then required to be sent to every member of the company and specified numbers of copies are required to be sent to the SECP, the stock exchange and the Registrar as well. Section 234 of the Ordinance states that the contents of the balance sheet should give a true and fair view of the affairs of the company and the profit and loss account/income and expenditure statement should give a true and fair view of the profit and loss/income and expenditure of the company for the financial year. Detailed standard schedules provided in the Ordinance are required to be followed in the preparation of these financial statements. In the case of listed companies, International Accounting Standards notified by the SECP in the Official Gazette are to be followed. The Code requires that a listed company cannot circulate its financial statements unless the Chief Executive and the CFO present such statements, endorsed under their signatures, for consideration and approval by the board of directors

and the board after such consideration and approval authorizes their issuance and circulation.[30]

In the matter of M/s. Quice Food Industries limited the Company had failed to hold its Annual General Meetings for the relevant year to lay therein annual audited accounts as required under sections158(1) & 233 of Companies Ordinance, 1984. Track record of the Company with regard to filing of accounts and holding of annual general meetings was also not satisfactory. Audited accounts pertaining to relevant financial years, had not been made in conformity with requirements of section.234 of Companies Ordinance, 1984 and it did not present a true and fair picture of the state of affairs of the Company. The executive director enforcement department issued notice under section.472 of Companies Ordinance, 1984 requiring Company to make good continuing defaults by removing Auditors' qualifications and submitting audited annual accounts for relevant years. Company was also advised that accounts should be prepared in such a way that they should depict true and fair view of the state of affairs of the Company; in addition, separate proceedings under sections 158, 170 & 245 of Companies Ordinance, 1984 were also initiated against the Company. Protection of investors/shareholders was one of the key objectives of Companies Ordinance, 1984, because investors/share-holders provided seed for capital formation. Said persons do not have any direct control over the company apart from that they elect directors for a period of three years and hand over affairs of the company to them in the expectation that they would manage the Company in a prudent manner. In order to protect their interests sections 233, 234 & 245 of Companies Ordinance, 1984 required that timely, adequate, meaningful and true and fair information be transmitted to them in the form of annual and interim accounts. Directors of the company were to submit to the Commission the audited financial statements of the company for relevant years prepared in accordance with section 234 of Companies Ordinance, 1984 depicting the true and fair view of the state of its affairs along with auditors report thereon, duly approved by share-holders within specified period. Directors of the Company, in case of non-compliance of said directives, were to be liable to action under section 495 of Companies Ordinance, 1984[31].

In the matter of M/s. Macdonald Layton Company Limited the Executive Director (Company Law Division) of the Security and Exchange Commission of Pakistan held

[30] The Company ordinance Section 234
[31] In the matter of M/s. Quice Food Industries limited. 2006 CLD 542

that directors of the Company in terms of provisions of section 233 of Companies Ordinance, 1984 were required to lay before its shareholders in the annual general meeting, audited balance sheet and profit and loss account and in terms of section 237 of the Ordinance, the directors were required to attach to said audited accounts consolidated financial statements of the group presented as those of a single enterprise and such consolidated financial statements had to be reviewed by the auditors. Company having failed to comply with said mandatory provisions of law, notice under section 472 of Companies Ordinance, 1984 was issued, requiring directors of company to arrange for audit of books of account of the company and submit audited/consolidated accounts within specified period. Explanation given by company for non-compliance of said mandatory provisions of law in response to said notice, did not justify contravention of the mandatory provisions of law. Business of the company though had been suspended since 1998 and it was in dire straits as regard its financial position, but it was even more important that shareholders of the company were provided authentic information regarding the state of affairs of the company. Audited annual financial statements were one such source of verified information provided by law. Directors of the company were ordered to comply with said mandatory provisions of law and in case of non-compliance of said directive, company and its Directors were liable to action under section 495 of Companies Ordinance[32].

1.16 The Role of Internal and External Auditors:

Under the code listed companies are required to establish such committees comprising of not less than three members including the Chairman, and with the majority of the members coming from the non-executive directors of the company and the chairman of the audit committee preferably being a non-executive director. The audit committee is required to meet once every quarter of a financial year and also whenever requested by the external auditor or head of internal audit. The CFO, head of internal audit and a representative of the external auditors are required to attend meetings of the audit committee, at which issues relating to accounts and audit are discussed. At least once a year, the audit committee is required to meet the external auditors without the CFO and head of internal audit and once a year the audit committee should meet with the head of internal audit without the CFO and external auditors. The Code also requires that there

[32]In the matter of M/s. Macdonald Layton Company Limited. 2006 CLD 667

be an internal audit function in every listed company whose head has access to the person chairing the audit committee.

All listed companies are required to ensure that internal audit reports are provided for the review of external auditors and that auditors discuss any major findings in relation to the report with the audit committee, which shall report matters of significance to the board of directors. Similarly, the Ordinance lays down a mechanism for the appointment and functioning of external auditors. Section 252 of the Ordinance states that external auditors have to be appointed at every annual general meeting to serve till the next general meeting and where the company fails to appoint auditors at the stated time or there is a vacancy for any other reason; SECP can appoint a person to fill the vacancy. The remuneration of auditors is fixed by the directors or the SECP or the company in a general meeting or in such a manner as the general meeting may determine, depending on who makes the appointment. Section 254 of the Ordinance mandates that the auditor for a public company or a private company which is the subsidiary of a public company or a private company having a paid up capital of three million rupees or more, has to be a Chartered Accountant within the meaning of the Chartered Accountant Ordinance of 1961. The auditors are required to prepare and submit audit report in accordance with the provisions of the Companies' Ordinance 1984.

In the matter of Mansha Mohsin Dossani Khan & Company Chartered Accountants versus Executive Director (Company Law Division) the auditors prepared and submit defective audit report contravention to the mandatory provisions of law. Enforcement Department of the Commission while examining the audited accounts of the company for the relevant year and auditors' report thereon observed that the company had not complied with provisions of sections 234 & 235 of Companies Ordinance, 1984 and that audit report submitted by auditors was full of defaults-Appellate forum held that auditors being the ultimate watchdog of the shareholders interest, were required to give a report on the accounts and books of accounts after conducting audit in accordance with prescribed procedure and requirements of Companies Ordinance, 1984 and International Accounting and Auditing Standards. Shareholders were the ultimate entity to whom the auditors were responsible and they must keep that fact in mind while auditing the books of accounts and reporting thereon was extremely important for the auditors to be vigilant and perform their duties and obligations with due care while auditing the accounts and

books of accounts. Lapses and non-compliance of mandatory provisions of law on the part of auditors could not be taken lightly. Audit report having been made otherwise than in conformity with requirements of section 255 of Companies Ordinance, 1984, representation of auditors who had signed that report had made him liable for punishment under subsection (1) of section 260 of the Ordinance. Accounts of the company in subsequent years having been rectified, instead of imposing maximum fine of Rs.100, 000, a fine of Rs.20, 000 was imposed on engagement partner of auditing company who had also assumed the sole responsibility of the audit of the company and no fine was imposed on other Auditors[33].

In the matter of Messrs Sarwar Awan & Company the Executive Director (Company Law Division) of Security and Exchange Commission of Pakistan held that auditors being the ultimate watchdog of the shareholders' interest, were required to give a report on the accounts and books of accounts after conducting the audit in accordance with prescribed procedure and requirements of Companies Ordinance, 1984 and International Accounting and Auditing Standards, but in several cases auditors were not performing their statutory duties with due care and in accordance with legal requirements. Law had made the auditors responsible for preparing a report in accordance with legal requirements and it was extremely important for auditors to be vigilant and perform their duties and obligation with due care while auditing accounts and books of accounts. Lapses, errors and non-compliance of requirements on the part of auditors, could not be taken lightly. Audit report having not been signed by auditors in conformity with the requirements of section.255 of Companies Ordinance, 1984, they had made themselves liable for punishment under subsection (1) of section 260 of the Ordinance. Fine of Rs.20, 000 was imposed on person of auditing company who was responsible for alleged default[34].

The Appellate Bench of Security and Exchange Commission of Pakistan in the matter of Gangat & Co, Chartered Accountants Versus Executive Director (Company Law Division) held that auditors being the ultimate watchdog of the shareholders interest, were required to give a report on the accounts and books of account after conducting the audit in accordance with a prescribed procedure and requirements of Companies

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[33] Mansha Mohsin Dossani Khan & Company Chartered Accountants versus Executive Director (Company Law Division). 2006 CLD 399

[34] In the matter of: Messrs Sarwar Awan & Company. 2006 CLD 431

Ordinance, 1984, and International Accounting and Auditing standards. If auditors found any irregularity, which was material and pervasive with regard to the, accounts, they were required to issue an adverse opinion in their report. Share-holders were the entity to whom the auditors were responsible and they must keep that fact in mind while auditing the books of accounts and reporting thereon. Auditors must realize their true role and restrain themselves from performing their duties indulgently. Capital required for the business of a company is contributed by its shareholders who could not necessarily be the persons managing the company. In the present case of a listed company, general public also contributed towards the equity of the company. Share-holders were stakeholders and ultimate beneficiaries, but they had no control over the way their company was managed by the directors appointed by them. Law in circumstances had provided that shareholders should appoint auditor who would be responsible to audit accounts and books of accounts and make out a report to them at the end of each year; it was extremely important for the auditors to be vigilant and to perform their duties and obligation with due care while auditing the accounts and books of account. Auditors in the present case had failed to perform their statutory obligations by not giving fullest information to the members and knowingly and recklessly ignored their observations and gave an inappropriate bill of health to the company's account. Taking lenient view, instead of imposing maximum penalty of Rs.100,000 on each partner of the firm, fine of Rs.25,000 each under subsection (1) of section 260 of Companies Ordinance, 1984, was imposed on all partners of the Auditing Company for making report otherwise than in conformity with the requirements of section 255 of Companies Ordinance 1984[35].

A person cannot be appointed as an auditor if; (a) he was, at any time during the preceding three years, a director, other officer or employee of the company; (b) he/she is a partner of, or in the employment of a director, officer or employee of the company; (c) he/she is the spouse of a director of the company; (d) he/she is indebted to the company; or (e) it is a body corporate. The Code of Corporate Governance further requires that only those firms are appointed as external auditors; (a) which have been given a satisfactory rating by the Quality Control Review Program of Institute of Chartered Accountants of Pakistan (ICAP) and (b) which are compliant with International Federation of Accountant's (IFAC) guidelines on Code of Ethics, as adopted by ICAP.

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[35] Gang at & Co, Chartered Accountants Versus Executive Director (Company Law Division). 2007 CLD 1256

Furthermore, the Code states that auditors will be required to only provide services in relation to audit except in accordance with the regulations and will be further required to observe applicable IFAC guidelines and it shall be ensured that they do not perform management functions or make management decisions. Additionally, listed companies are now required to change their auditors every five years. The Code further requires that no listed company shall appoint as CEO, CFO, an internal auditor or a director someone who was a partner of the firm of its external auditors or an employee involved in the audit of the listed company at any time during the two years preceding such appointment or someone who is a close relative, i.e. spouse, parents, dependent and non-dependent children, of such partner or employee. All listed companies are required by the Code to ensure that the firm of external auditors or any partner in that firm and his spouse and minor children do not at any time, hold, purchase, sell or take any position in shares of the listed company or any of its associated companies or undertakings.

2. Protection through the Regulatory Agencies:

The SECP play an important regulatory role in the Pakistani corporate governance environment. The following is an overview of some of their more important powers under the Ordinance in the context of the protection of the rights of shareholders and creditors.

2.1 Power of Registrar to Call for Information or Explanation:

Section 261 of the Ordinance provides that if the Registrar thinks that any information, explanation or document is necessary, he may in writing call for it within a specified time frame not less than 14 days. If no Information furnished within specified time or inadequate information provided, the Registrar may, through a written order, call for production of any books or papers which he considers necessary and it will be duty of the company and such persons to provide the required documents within the specified time frame.

2.2 Seizure of documents by Registrar:

Section 262 of the Ordinance provides that where the Registrar has reasonable grounds to believe that books or papers of or relating to any company or any chief executive or officer of such company or any associate of such person, may be destroyed, mutilated,

altered, falsified or secreted, then after obtaining permission from magistrate of the first class or Court, he can search and seize such books and papers. Documents are to be returned within thirty days after seizure unless SECP gives another thirty-day grace period.[36] The Criminal Procedure Code is to be followed during searches. The SECP has wide-ranging investigative powers into the affairs of a company, which are as follows.

2.2.1 Investigation of Affairs of Company on Application by Members or Report by Registrar:

Section 263 of the Ordinance provides that the SECP inspectors may investigate on: (a) in case of company with share capital, on application of members holding no less than one-tenth of total voting power; (b) in case of company with no share capital, on application of no less than one-tenth of persons on companies register as members; and (c) in case of any company, on receipt of a report under Section 231(5) of the Ordinance a report by an officer of SECP when inspecting accounts under this section or the Registrar's report under Section 261(6) of the Ordinance.

The SECP has further powers to initiate investigations into the affairs of a company, either due to a board resolution requesting such an investigation or a court order directing one. Section 265 of the Ordinance says that the SECP may appoint inspectors for investigation if;

(a) The company, by a resolution in general meeting or,

(b) The court, by order declares that the affairs of the company ought to be investigated. SECP may also investigate after giving Company show cause notice if in the opinion of SECP certain circumstances exist which suggest that

(i) Business being conducted with intent to defraud or unlawful purpose;

(ii) Framers of company guilty of fraud, misfeasance, breach of trust, misconduct towards company or any of its members or have been carrying unauthorized business;

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[36] The Company ordinance Section 262

(iii) Affairs of company so conducted so as to deprive members of reasonable return

(iv) Members not given all information which they might reasonably expect;

(v) Any shares of company allotted for inadequate consideration; or

(vi) Affairs of company not being managed in accordance with sound business principles or prudent commercial practices.

In the matter of Chief Executive Barex Limited Versus Executive Director (Company Law Division), the Executive Director (Company Law Division) of the Commission appointed Chartered Accountant to investigate the affairs of company. Area of investigation as identified by Executive Director was the illegalities committed in holding of elections of directors and continuation of Chief Executive in violation of sections 180, 199 & 200 of Companies Ordinance, 1984; non-presentation of accounts in annual general meetings and appointment of auditor in violation of section 158, 233 & 252 of Companies Ordinance, 1984; dispute relating to transfer and allotment of shares; mismanagement and misappropriation of funds and other matters relating and incidental to said matters. The Appellate Bench of Security and Exchange Commission of Pakistan held that where a Company did not hold annual general meeting within prescribed time without any special reason, then it could be inferred that Company was not taking interest to protect the interest of shareholders. No sufficient evidence had been brought before Executive Director in rebuttal by appellants to show compliance with certain statutory requirements of the Ordinance. Appellants had admitted to have committed violations of the Ordinance. Investigations into the affairs of company in the terms set out in impugned order was necessary and it was in the interest of justice to ascertain the extent of violations committed by appellant and as a consequent the prejudice caused to minority shareholders. Appellate Bench of the Commission dismissed the appeal in circumstances.[37]

Similarly in the matter of Dawood Fibre Limited Versus Executive Director (Company Law Division), the Commission appointed inspectors to investigate the affairs of

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[37] Chief Executive Barex Limited Versus Executive Director (Company Law Division).2002 CLD 1309

company. The appellant Company challenged the order of Commission before the appellant bench of the Commission. Appellate Bench of the Commission held that Company was listed company and the Commission in that regard had a dual role of beneficial regulation and control of corporate sector as well as protection of investors and the Commission could not be expected to sit in idle. Authority to carry out inspections had been provided to Commission by law where the company was not being conducted in accordance with sound business and prudent commercial practices. Impugned order passed by the Commissioner could not be interfered in appeal[38].

2.2.2 Power of SECP to initiate action against management:

Section 271 says that if the SECP is of the opinion that (on the basis of a report under Section 269 of the Ordinance) that:

(i) Business being conducted with intent to defraud or unlawful purpose;

(ii) Framers of company guilty of fraud, misfeasance, breach of trust, misconduct towards company or any of its members or have been carrying unauthorized business;

(iii) Affairs of company so conducted so as to deprive members of reasonable return;

(iv) Members not given all information which they might reasonably expect;

(v) Any shares of company allotted for inadequate consideration; or

(vi) Affairs of company not being managed in accordance with sound business principles or prudent commercial practices then SECP may apply to court.

The court may order (a) removal from office of director, officer, managing agent or chief executive (b) that directors should carry out specified changes in management or accounting policies, (c) a meeting of members to consider specified matters and take

[38] Dawood Fibre Limited versus Executive Director (Company Law Division). 2006 CLD 283

appropriate remedial action, or (d) annulment of any existing contract which is to detriment of company or members or to benefit of any officer or director.[39]

In case title Diamond Industries Limited Versus Appellate Bench of Security and Exchange Commission of Pakistan the Security and Exchange Commission of Pakistan issued show cause notice to the Company for the appointment of inspectors to investigate in the affairs of the company for illegality and irregularity committed by the company. A reply was filed to-the said show cause notice. After giving an opportunity to the company of hearing the inspectors were appointed by the Commission to investigate in the affairs of the company to bring truth. The company filed appeal against the order of the SECP for the appointment of inspectors to investigate in the affairs of the company. The Peshawar High court while rejecting appeal held that investigation under section 271 of the Companies Ordinance 1984 is just probing into the matter, to reach at the truth and not a penalty or punishment, even does not include a reprimand or warning. Commission at the conclusion of investigation can prosecute a person/member under Sections 270 & 271 of the Companies Ordinance. If reputation of a person or of an entity is kept in view and on such ground hesitation is felt to investigate the matter, then no step can be taken even against the actual culprits, who have committed the offence[40].

2.2.3 SECP's Powers to Initiate Proceedings for Recovery of Damages or Property:

Under Section 278 of the Ordinance, the SECP may, if from a report under Section 269, it appears to it that in the public interest, proceedings should be brought by company or body corporate whose affairs are being investigated for recovery of damages in respect of fraud, misfeasance, breach of trust or other misconduct or any property, which has been misapplied or wrongfully retained, bring proceedings in the name of such entity which will indemnify SECP for any costs and expenses.

2.3.4 Powers of SECP under the Security and Exchange Ordinance 1969 and the SECP Act:

The SECP draws its basic powers of registering and regulating stock exchanges as well as regulating issuers under the Security and Exchange Ordinance 1969. The Security and Exchange Ordinance is significant for its detailed treatment under Section 15-A of

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[39] The Company ordinance Section 271

[40] Diamond Industries Limited versus Appellate Bench of Security and Exchange Commission of Pakistan. 2002 CLD 1714

prohibited insider trading. Section 20 of the Security and Exchange Ordinance allows the SECP to issue prohibitory orders for preventing, any a contravention of any provision of the Ordinance or any rules made there under. Section 21 gives the Federal Government the power, suo moto or on an application, to appoint any person to inquire into (i) the affairs of any stock exchange, or (ii) the dealing/trading being conducted by any broker, member, director or officer of a stock exchange. The SECP Act deal in greater detail on the structure, functioning and powers of the SECP. Some of the significant stated powers of the SECP under Section 20 of the SECP Act include

1. Prohibiting fraudulent and unfair trade practices relating to the securities market;

2. Conducting investigations in respect of matters relating to the SECP Act and the SECP Ordinance and in particular for the purpose of investigating insider trading in securities and prosecuting offenders;

3. Regulating substantial acquisition of shares and the merger and take-over of companies;

4. Considering and suggesting reforms of the law relating to companies and bodies corporate, securities markets, including changes to the constitution, rules and regulations of companies and bodies corporate, Stock Exchanges or clearing houses;

5. Promoting investors education and training of intermediaries of securities market; Encouraging organized development of the capital market and the corporate sector in Pakistan.

Section 22 of the SECP Act also gives the SECP adjudicative powers to adjudicate upon the rights of any person whose application on any matter it is required to consider in the exercise of any power or function under the SECP Act. Section 29 of the SECP Act empowers the SECP to conduct investigations in respect of any matter that is an offence under the SECP Act.

2.3.5 Protection through the Courts:

The primary power of the courts to intervene to prevent oppression of shareholders and mismanagement of the affairs of the company is through Section 290 of the Ordinance. According to Section 290 of the Ordinance, if any member/members holding not less than 20% of issued share capital of a company or creditor/creditors having an interest not less than 20% of the paid up capital, complains, or the Registrar is of the opinion, that the affairs of the company are being conducted or are likely to be conducted in a manner, that is unlawful or fraudulent, or in a manner not provided for in its memorandum, or in a manner oppressive to the members/creditors/ or any of the members/creditors or in a manner prejudicial to the public interest, such person or Registrar may make an application to the Court by petition for an order under this section. The Court, on such petition if it is of the opinion that any of the above is taking place may make such order as it thinks fit to bring an end to the matters complained.

The courts have been active in recent years in the development of jurisprudence in the various important areas of corporate governance. Some Instances are as follows:

In 2004, petition was filed by the plaintiff challenging the clause vii of the Code of Corporate Governances whereby all the listed companies were required to change their external auditors every five year or the companies were required to rotate the partner in charge of its audit engagement after obtaining the consent of the Securities and Exchange Commission. The plea raised by plaintiff was that clause vii of the Code of Corporate Governances was ultra vires of section 34(4) of the Securities and Exchange Ordinance, 1969 and section 252 & 254 of Companies Ordinance 1984, the court held that the purpose of such amendments was to protect the interest of innocent share-holders who despite investing their hard savings had no access to the accounts of the listed companies, law enforced through such amendments being in public interest could not be deemed to be ultra wires of constitution.[41]

In another case the High Court observed that the auditors are the ultimate watchdogs of the shareholders' interests. According to the set practice, the auditors are required to give a report, which is either "clean" or "qualified". By issuing a "clean" report, the auditors certifies that the financial statement reflects a "true and fair" view of the company's

[41] A.F Ferguson & Co Versus The Securities and Exchange Commission of Pakistan, 2004 CLD1433(a)

affair and a "qualified" report subjects such opinion to some observation of irregularity or inconsistency. The High Court highlighted and denounced the practice adopted by the managements of some large companies, which are dependant on public confidence, frenziedly trying to secure a "clean" audit report from their auditors. The High Court pointed out that since the auditors are recommended and virtually appointed by the board of directors, some of them are made to condescend to the management's demand and declared that it caused a devastating effect if the auditors put a seal of approval on the misleading accounts of a company.[42]

The High Court made another very significant addition to minority shareholder rights protection by underlining the fundamental importance and duty of the courts to the protection of minority shareholder rights. It was observed by the High Court, that the court is not a bystander obliged to grant approval to all schemes of arrangements approved by special majority of shareholders specified in Section 284 of the Ordinance dealing with a compromise of the company with its creditors and members. The court can review the proposed scheme and decline approval, even though scheme approved by requisite majority, in a situation where the majority shareholders of a company had voted in a manner coercive or oppressive to the minority or where the majority shareholders had not voted in the interest of shareholders as a class. The High Court further observed that wherever the court reaches the conclusion that a scheme is unfair and conscionable, and to which material objections have been raised by any shareholder either in a general meeting or before the court, it would become a duty of the court not to approve the scheme. The fact that the objecting shareholder constitutes a small minority in proportion to the majority will be wholly irrelevant in such circumstances. Elaborating further on the Section 284 provision, it said that Section 284 of the Ordinance which required the sanction of the Court to any scheme of arrangement is meant for the protection of the rights of powerless small minorities who can be outvoted at general meetings and cannot, therefore, adequately safeguard their interests on the strength of their voting rights alone. It is, therefore, open to these minorities to show to the Court that the proposed scheme of arrangement is unfair, unreasonable and prejudicial to their interest, or to the interests of the shareholders generally.[43].

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[42] Institute of Chartered Accountants of Pakistan v. Messers Hyderali Bhimji & Co. 2002 CLD 1207.

[43] Kohinoor Raiwind Mills Limited v. Kohinoor Gujar Khan. 2002 CLD 1314.

Chapter IV

Assessment of the impact of the Code of Corporate Governance:

4.1 Introduction:

The Securities and Exchange Commission of Pakistan introduced the Code of Corporate Governance in 2002, with the collaboration of Institute of Chartered Accountants of Pakistan. The code has been incorporated in the listing regulations of the stock exchanges and is applicable to all public listed companies in Pakistan. In order to evaluate the impact of the Code of Corporate Governance generally and particularly on cement and leasing sector the questionnaire was developed and dispatched, via mail and email, to 13 listed companies in cement and leasing sector. A questionnaire was designed in the light of project report published by the Securities and Exchange Commission of Pakistan in September 2003 "Impact Assessment of the Code of Corporate Governance 2002" the Code of Corporate Governance 2002, Listing Regulations, and the Companies Ordinance 1984. The questionnaire consisted of 22 questions, out of which nearly 21 questions could be answered simply by "Yes" or "No" manner. The questionnaire include all issues relating to minority shareholder, audit committees, composition of the board, compliance with code provisions, financial disclosure requirements and appointment of important officials such as chairman of board of directors in line with the code provisions. One descriptive question was included requiring sample companies suggestion regarding the effective implementation of the Code of Corporate Governance. The questionnaire was sent to around 13 listed companies of the country. However the response to the questionnaire was not very encouraging. Despite many reminders and telephonic requests out of 13 companies only 3 companies responded to the questionnaire. The complete list of the 13 companies to whom the questionnaire was dispatched, via mail and email is shown in Table 4.1 and the companies who responded to the questionnaire are shown in Table 4.2

Table 4.1 List of Companies to whom the Questionnaire was dispatched

1. Cherat Cement Company Limited
   Modern motors House, Beamont road, Karachi
2. D.G Khan Cement Company Limited

Nishat House, 53-A, Lawrence road, Lahore

3. Fecto Cement Limited

   35- Darulaman Housing society, Block 7/8, Shahrah-e-Faisal, Karachi

4. Kohat Cement Company Limited

   House No 64 -E-I / D, Gulberg-III, Lahore

5. Lucky Cement Company Limited

   6-A, Muhammad Ali Housing society,

   A.Aziz Hashim Tabba Street, Karachi

6. Pakistan Cement Company Limited

   3 rd Floor, Habib Bank Tower, Jinnah Avenue, Blue Area, Islamabad

7. Pioneer Cement Company Limited

   7th Floor, Lakson Square Building No 3,

   Sarwar Shaheed Road, Karachi

8. Deawan Hattar Cement Company Limited

   Hattar Industrial Estate, Haripur

9. Best way Cement Company Limited

   Hatter Industrial Estate, Haripur

   Registered Office Best way House, F 7/2, Islamabad

10. Saudi Pak Leasing Company Limited

    2nd Floor, High Rise Block, Saudi Pak Tower,

    Jinnah Avenue, Blue Area, Islamabad

11. Orix Leasing Pakistan Limited

    Overseas Investors Chamber of Commerce Building

    Talpur Road, Karachi

12. Union Leasing Company Limited

    6th Floor, New Jubilee Insurance House

    I.I.Chundrigar Road, Karachi

13. Askari General Insurance Company Limited

    101-F, Fazal-ul-Haq Road. Blue Area, Islamabad

Table 4.2 List of Companies that Responded to the Questionnaire

1. Saudi Pak Leasing Company Limited
   2nd Floor, High Rise Block, Saudi Pak Tower,
   Jinnah Avenue, Blue Area, Islamabad
2. Best way Cement Company Limited
   Hatter Industrial Estate, Haripur
   Registered Office Best way House, F 7/2, Islamabad
3. Askari General Insurance Company Limited
   101-F, Fazal-ul-Haq Road. Blue Area, Islamabad

4.3 Purpose and Objective of the Study:

The Code of Corporate Governance was introduced in the country with the aim that it will bring transparency and efficiency within the corporate sector and will provide a mechanism for the protection of the interest of shareholders in companies which will ultimately improves the investment climate in the country by raising investor confidence. It is well-establish fact that by enforcing good corporate governance practices is essential to attract capital, improve efficiency of financial markets and to achieve sustained economic growth. In order to assess the effects of the Code a systematic and detailed study is required to evaluate the state of corporate governance in Pakistan. This not only requires considerable times but also finances. Therefore the study was limited only to evaluate the impact of the Code on the organizational and operational efficiency of the cement and leasing companies. The purpose of study was to examine whether the companies have taken steps for protection of shareholder rights, role of non-executive directors, independence of board of directors, quality of financial reporting disclosures, effectiveness of audit committees and quality of external audit and compliance with legal requirements.

4.4 Findings of the Questionnaire:

The Questionnaire was designed to study the compliance with the Code of Corporate Governance in cement and leasing sector and the extent and effect of implementation of the Code. The findings of the Questionnaire have been discussed under the following headings:

- Composition of the Board of Directors.
- Meetings of the Board
- Financial disclosure framework
- Statement of Ethics and Business Practices
- External Auditors
- Statement of compliance with the Code of Corporate Governance.
- Audit committee
- Suggestions regarding the effective implementation of the Code of Corporate Governance

4.4.1 Composition of the Board of Directors:

Out of 3 companies, two companies had representation of minority shareholders on their board and stated that minority shareholders are facilitated to contest the election for the slot of board of directors. All companies that responded to the questionnaire stated that their boards of directors include independent directors. Two companies stated that the chairman of the board of directors is elected among the non-executive directors while one company stated that chairman of board of directors is elected among the executive directors. As regard the percentage of shares of the executive directors in the company one company responded that executive directors hold 25% shares in the company while other company responded that only one i.e. chief executive holds share in company while third company stated that executive directors do not hold shares in the company. All the companies which responded to the questionnaire stated that all their directors on board of directors are national tax payers. All the companies who responded to the questionnaire stated that they donot know whether their company has taken steps against directors serving in other companies. As regard the action against the directors who have been convicted the companies responded that it never happened in their companies therefore no action has been taken.

Table 4.4.1 Response Regarding Composition of the Board of Directors:

Are minority shareholders facilitated to contest election for the company's board of directors?

a) Yes (66 %)

b) No

c) Don't know (33 %)

Does your company's board of directors include independent directors?

a) Yes (100 %)
b) No
c) Don't know

Has the Chairman of Board of Directors been elected from?

a) Executive Directors (66 %)
b) Non- Executive Directors (33 %)

What is the share of executive directors in your company?

a) 50%
b) 75%
c) 25% (33 %)
d) Others please specify.

Has your company taken steps against directors serving in other companies?

a) Yes
b) If yes how often
c) Don't know. (100 %)
d) Under consideration

How many directors are national tax payers in your company's board of directors?

a) All (100 %)
b) Majority of them
c) Few of them
d) Others, please specify

What type of action has been taken against the directors who have been convicted?

a) Removal from the board
b) Never happened (100 %)

4.4.2 Meetings of the Board of Directors:

Out of 3 companies, two company has stated that the meetings of the boards of directors of their company are held once in every quarter while other company stated that the meetings of the board of directors of their company are held once in every six months. All the companies which responded to the questionnaire stated that minutes of the meetings are properly recorded in the minute's book and subsequently circulated to the directors. The question regarding holding of number of training courses conducted by their company to acquaint the staff with their duties and responsibilities two companies responded that less than five training courses conducted by their company while other company stated that more than ten such courses were conducted by their company to acquaint the staff with their duties and responsibilities.

Table 4.4.2 Response Regarding Meetings of the Board of Directors

The meetings of the board of directors of your company are held:

a) Once in every quarter (66%)
b) Once in every six months (33%)
c) Once in a year
d) On need basis

Are the minutes of the meeting properly recorded in the minute's book and subsequently circulated to the Directors

a) Always (100 %)
b) Sometimes
c) Quite often

The number of training courses conducted by your company to acquaint the staff with their duties and responsibilities of management are:

a) Less than five (66 %)
b) More than five

c) More than ten (33%)

d) Others, please specify

4.4.3 Financial Disclosure Framework:

All the companies, which responded, declared that the shareholders are informed about the financial statements of the company in the annual reports. One company stated that the same is also placed on the company website for the information of the shareholders as well for the general public. As regard the methodology of financial reporting framework in the company one company responded that their financial reporting framework is based on annual audited financial statements while other companies stated that their financial reporting system is based on quarterly, Half- yearly, annual audited financial statements. One out of three companies declared that they offered 2o% share capital in the stock exchange for the general public and other institutions. While other companies stated that they offered 5o% share capital in the stock exchange for the general public

Table 4.4.3 Response Regarding Financial Disclosure Framework:

How shareholders are informed about the financial statements of your company?

a) In annual report (100 %)

b) Directors report to shareholders

c) Through mail

d) Others, please specify

What is the frequency of the financial reporting framework of your company?

a) Quarterly unaudited financial statements

b) Half- yearly financial statements (66 %)

c) Annual audited financial statements (33%)

d) Others, please specify

What %age of share capital is offered in the stock exchange by your company?

a) 10%

b) 20% (33 %)

c) 30%

d) Others please specify 50% (33%)

4.4.4 Statement of Ethics and Business Practices:

All the companies which responded to the questionnaire stated that their companies prepared Statement of Ethics and Business Practices after the introduction of the Code of Corporate Governance and there was no concept of preparation of such statements before the introduction of the Code of Corporate

Table 4.4.4 Response Regarding Statement of Ethics and Business Practices

Has your company prepared Statement of Ethics and Business Practices after the introduction of the Code of Corporate Governance?

a) Yes (100 %)

b) No

c) Under consideration

Has your company prepared Statement of Ethics and Business Practices before the introduction of the Code of Corporate Governance?

a) Yes

b) No (100 %)

c) Sometimes

d) Don't know

4.4.5 External Auditors:

All the companies which responded to the questionnaire declared that the external auditors have been appointed in conformity with the guidelines stated in the Code of Corporate Governance. All the companies stated that the external auditors of their companies are appointed for a period of one year. One of the companies which responded to the questionnaire further declared that the external auditors are appointed in every annual general meeting. Out of 3 companies, 1 company which responded to the questionnaire

further stated that the external auditors of their company are changed after every two years while other company stated that the external auditors are changed after every five years. While other company stated that the external auditors are appointed by the board of directors if required and requested by the Audit Committee.

Table 4.4.5 Response Regarding Appointment of External Auditors:

The external auditors of your company are appointed for a period of

a) One year (100%)
b) Two years
c) Three years
d) Others, please specify

How often the external auditors of your company changed

a) After two years (33%)
b) After five years (33%)
c) After ten years
d) Other, specify

4.4.6 Statement of compliance with the Code of Corporate Governance:

All the companies which responded to the questionnaire declared that their companies have submitted a statement of compliance along with the annual report in conformity with the guidelines stated in the Code of Corporate Governance.

Table 4.4.6 Response Regarding Statement of compliance with the Code of Corporate Governance

Has your company submitted a statement of compliance along with the annual report?

a) Yes (100%)
b) No
c) Under consideration

4.4.7 Audit Committee:

All the companies which responded to the questionnaire declared that they have established Audit Committees. The Chairman of the Audit Committee is elected from the Non-Executive Directors whereas only one company reported that the Executive Director is the Chairman of the Committee.

Table 4.4.6 Response Regarding Audit Committee

Has an Audit Committee been established in your Company?

a) Yes (100%)
b) No

The Chairman of the Audit Committee is elected from

a) Executive Director (33%)

b) Non-Executive Director (66%)

4.5 Evaluation of Corporate Governance In Sample companies:

The Code of Corporate Governance in March 2002 as a first step towards systematic implementation of principles of good corporate governance. The Code has been incorporated in the listing regulations of the stock exchanges and is applicable to all public listed companies. The object of the Code is to provide a framework by which the business and management of listed companies are to be directed and controlled. The following are the main salient features of the Code of Corporate Governance that deal with the role of management and directors of companies

The Code encourages representation of independent non-executive directors and those representing minority interests on the boards of directors of listed companies. As a further guarantee of compliance with this provision, the Code requires that the chairman of a listed company "shall preferably be elected from among the non-executive directors of the company and that the board of directors shall clearly define the respective roles and responsibilities of the chairman and chief executive, whether or not these offices are held by separate individuals a the same individual."

The Code requires every listed company to establish an audit committee that will comprise not less than three members, including the chairman. Majority of the members of the committee, "it shall be from among the non-executive directors of the company" To further enhance their role, it requires that the chairman of the audit committee be preferably a non-executive director.

(1) Appointment and removal, remuneration and terms of reference of the CFO and Company Secretary shall be determined by the CEO subject to the approval of the Board of directors.
(2) The financial statements, presented to the Board for consideration, shall bear the signatures of the CEO and CFO.
(3) New appointments of CFO and Company Secretary must be made in accordance with the prescribed qualifications
(4) Statement of compliance with the Code of Corporate Governance is required to be published by companies to set out the extent of compliance with the Code. The auditors of listed companies have been made responsible for reviewing and certifying this statement.

The responses received from the questionnaires suggest that listed companies recognize the importance of the corporate governance for better company performance, higher profits, good working relations between the management and owners and above all the growth of the economy. As regards the adoption of the various provisions of the Code, the results are very encouraging. This analysis is based on the information received from three companies.

According to the information collected, all the companies who responded stated that they have included independent directors in the companies' board of directors. It means 100% companies have adopted this clause of the Code. According to the Code, the Chairman of a listed company is to be preferably elected from among the Non-Executive Directors of the companies out of three companies two companies responded that Chairman of a company is elected from among the Non-Executive Directors while other company stated that Chairman of a company is elected from among the Executive Directors. It means 66% companies have adopted this clause of the Code.

According to the Code, the directors are neither allowed to engage in stock brokerage nor serve in more than 10 listed companies. The results of the questionnaire show that this violation never took place in the responded companies. The responses received from the questionnaires suggest that hundred percent of the listed companies directors are tax payers as they have been allotted national tax numbers for paying taxes The board of directors of the companies now meets once in every quarter as required under the Code in order to discuss the problems and decide on the issues confronting the company. The minutes of the meetings are always circulated to the board of directors and officers for recording comments and seeking approval of the decisions agreed during the board meetings .One good development that was noticed was that listed companies who responded are preparing statement of the ethics and business practices in order to establish a standard Code of conduct for the directors and employees and there was no concept of preparation of such statements before the introduction of the Code of Corporate in listed companies who responded. The Code calls upon the listed companies to organize training courses for enhancing the capacity of its staff about their duties and responsibilities. All the companies which responded have started organizing such courses for the training of its staff, employees and management. However, the numbers of courses conducted are very few and insufficient. Two Companies reported that they have organized less than 5 courses for such purpose, while other company stated that they have organized more than 10 courses. As regards audit and accounts, the information obtained reveals that all the listed companies are now publishing and circulating the quarterly unaudited financial statements, along with directors' review on the affairs of the listed company for the quarter, six monthly and annual audited financial statements. The financial statements of the companies are provided to the shareholders in various sources like the annual report, director's report to the shareholders, through mail and the newspapers.

The companies reported that external auditors of the company are appointed for a period of one year on the recommendation of the board of directors. All listed companies are required to change their external auditors every five years. The findings of the questionnaire demonstrate that the listed companies don't change their external auditors after the lapse of five years only one company stated that external auditors are changed after every five years. They feel that there is no need to change the external auditors as long as their performance is

satisfactory. All the listed companies which responded stated that they have published and circulated a statement of compliance along with the annual report to the SECP.

According to the Code, the board of directors is required to establish an audit committee and the chairman of the committee is from the non-executive directors. The results of the questionnaire show that Audit Committee has been established by the companies and the Chairman of the Audit Committee is elected from the Non-Executive Directors whereas only one company reported that the Executive Director is the Chairman of the Committee. All the listed companies which responded stated in favor of the SECP with regard to its capacity and ability to enforce the key provisions of the Corporate Governance Code.

Chapter V

ASSESSMENT OF THE IMPACT OF THE CODE – PROGRESS AND PROBLEMS:

5.1 Introduction:

Corporate governance is a worldwide phenomenon. It has received wide attention of policy makers in the developed and developing countries in the recent years. The government of Pakistan has set up Securities and Exchange Commission of Pakistan (SECP) in 1997 to lay down the foundation of good corporate governance by building legal and regulatory framework for the better management of the corporate sector business entities. The Securities and Exchange Commission of Pakistan in pursuance of its policy of regulation has enacted and enforced various laws and regulations in order to create a business friendly environment In addition to many laws in place, it adopted the Code of Corporate Governance in March 2002 in order to further strengthen the regulatory mechanism. The method of framing such Code and its enforcement and application in letter and spirit is very important for effective corporate governance. The Code primarily aims at the establishment of a system whereby a company is directed and controlled by its directors in compliance with the best practices enunciated by the Code so as to safeguard the interests of stakeholders. It proposes to restructure the composition of the board of directors in order to introduce representation by minority shareholders and broad-based representation by executive and non-executive directors. It seeks to achieve the objectives of good corporate governance by strengthening the corporate working, internal control system and external audit requirements.

5.2 Progress and Achievements:

The information received from the companies reveals that implementation of the Code has resulted in significant organizational and corporate culture improvements, as compared to the situation prior to the implementation of the Code. In the following lines the progress and achievements attained by companies after the implementation of the Code will be discussed.

5.2.1 Board of Directors

Prior to the implementation of the Code the boards of directors were not as cognizant of their responsibilities, as they are now after the implementation of the Code. The Code provides that all the listed companies must have representation of independent director in their board to make the same more effective. The Code encourages representation of independent non-executive directors. Accordingly, listed companies are encouraged to give at least 25% representation to non-executive directors on their boards and appoint a non-executive director as the chairman of the board. Moreover, majority of members of the audit committee and, preferably, its chairman must be from among the non-executive directors. Non-executive directors can add value to the boards of directors in the operations of a company, like maintaining independent checks and balances on the authority of executive directors and CEO, bringing specific skills and expertise by participating in audit committees, chairing the board of directors, actively participating in all board meetings and carrying out the responsibilities laid down in the Code of Corporate Governance. Since non-executive directors are not involved in the day to day running of the company, therefore they are expected to consider the broader, strategic issues facing the company and identify risks and opportunities.

5.2.2AuditCommittee:

Prior to implementation of the code the audit committees were not in existence now half-yearly and annual accounts are reviewed and approved by the audit committee, which is a new concept introduce by the Code. The audit committee is generally required to review and monitor the effectiveness of the system of internal control within the company, oversee its internal audit function. Being a board committee, the audit committee functions within the parameters laid down by the board. However, it draws its strength from the independence of its members, who being independent non-executive directors are expected to question the processes and disclosures within the company. Keeping in view the significance of audit committees in improving corporate governance practices, the Code of Corporate Governance requires that all listed companies to constitute an audit committee. Majority of the members of the committee and preferably its chairman must be drawn from among the non-executive directors of the company.

5.2.3 Internal Audit:

In the past internal audit function has always been considered as superfluous, unwanted. However, the function is now gradually gaining acceptance and its efforts are also acknowledged for providing meaningful assistance to the audit committee, and to the board of directors, for ensuring implementation of internal control in the organization. The Code requires that the director's report to include a statement to the effect that the system of internal control is sound and has been effectively implemented and monitored. The Code has also made the audit committee responsible for ascertaining that the accounting and internal control systems are adequate and effective, further appropriate measures are taken to safeguard the company's assets as well as reviewing the scope and extent of internal audit.

5.2.4 ExternalAuditors:

The external auditors after implementation of the Code are more independent in discharging of their legal and professional obligations. The external auditors are now responsible for limited review of half-yearly accounts and are required to issue "Review Report to the members on Statement of Compliance". They are also called upon by the audit committee's for discussion on significant accounting and financial issues. The shareholders are now being kept more well-informed through issuance of quarterly and half-yearly accounts. Frequent issuance of the reports enhances investor confidence on the companies.

5.2.5 Pakistan Institute of Corporate Governance:

The Pakistan Institute of Corporate Governance is established in order to educate directors on corporate governance issues and to improve the general understanding of corporate governance in the business community and in government. The Pakistan Institute of Corporate Governance was established as a not-for-profit company in Dec 2004, limited by guarantee and without share capital. The objectives of the Institute are;

1. To represent, express, promote the findings and opinions of the members of the Institute on events and issues relating to the effective management of business and affairs of corporations in Pakistan.

2. To collect and circulate information and data pertaining to corporate governance.

3. To provide research materials to members.

4. To organize conferences, seminars, lectures and exhibitions for members or the public.

5. To establish and maintain a library & research centre with access to reviews, periodicals, newspapers, investment updates, companies' statistics and data.[1]

Key Corporate Governance Issues:

Following are the key corporate governance issues in the Pakistan. Which are major obstacles in the way of effective implementation of the Code of Corporate Governance. In the following lines these issues will be discussed

5.3.1 Predominance of Family-Controlled Corporations:

There are three main types of listed companies in Pakistan, they are, multinational companies, family-controlled companies, and state-owned companies. Pakistani companies historically have been family-controlled, especially those in the area of textile, automotive, tobacco, and agricultural sectors. Today, the majority of companies in Pakistan are under family control. The study conducted by SECP in 2002, shows that from among the local listed companies, the dominance of the family as a controlling unit is apparent as the family unit controls half of the equity of an average listed textile company either through direct ownership or by virtue of ownership through associated companies. Apart from textiles, other sectors are also characterized by family dominance where the family directly or indirectly controls approximately one third of the equity of an average company. A family control shares in a company either by owning shares or indirectly through associated companies, which are under their control[2].

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[1] The Pakistan Institute of Corporate Governance.Avaiable at web site http://www.picg.org.pk/. Visited on 02 April 2008.

[2] Impact Assessment of the Code of Corporate Governance 2002, published by the Securities and Exchange Commission of Pakistan page 22.

5.3.2 Pakistan's Equity Culture:

Pakistan's equity culture is still developing. The lack of focus on an equity culture in the 1980s, the high returns on National Savings Schemes and easy access to bank loans in the 1990s all discouraged an equity culture in Pakistan. The Karachi Stock Exchange is the largest of the three equity markets in Pakistan and has been one of the best performing markets in the world over the past 4 years. In the year 2006 there were 663 companies listed on the Karachi Stock Exchange with a total market capitalization of approximately US$54 billion. However, equity financing is still not a priority because of lack of competition in various industries[3].

Family-controlled companies are often satisfied with their position in the market and prefer not to risk weakening family control by selling shares to minority investors. These companies do not actively trade in the stock exchanges because they have alternative modes of raising capital. The ownership structure of companies enables them to get finances through internal sources or financial credit rather than raising capital at the stock exchanges. The people prefer to do business with their friends and family members in Pakistan. Hence, inter companies financing is a popular option that many companies exercise, especially those belonging to business groups.

5.3.3 Independent Directors under the Code of Corporate Governance:

Clause (i-a) of the Code encourage the listed companies to ensure effective representation of non-executive independent directors, including those representing minority interests, on their Boards of Directors. Additionally, Clause (i-b) of the Code recommends that the Boards of Directors of listed companies include at least one non-executive independent directors representing institutional equity interest of a banking company, Development Financial Institution, Non-Banking Financial Institutions (including a modaraba, leasing company or Financial Institution, Non-Banking Financial Institutions (including a modaraba, leasing company or investment bank), mutual funds and insurance companies. It is further recommended by Clause (i-c), that for listed companies, the executive directors (working or whole-time directors) as a group should not constitute more than 75% of the

[3] Journal of Legal Technology Risk Management Vol. 1 Fall 2006 available at http://www.ltrm.org/journal/vol1issue1/issue1vol1Hamid_Kozhich.pdf, Visited on 29 March 2008.

elected directors (including the Chief Executive)[4]. Therefore, the Code takes a number of important steps that bring corporate governance regulations in Pakistan in line with international best practice. It is also important to point out that the introduction of the concept of non-executive independent directors in Pakistan's corporate governance regulations is an important addition brought about by the code, as the Companies Ordinance 1984 have no such provision. However, the Code does not require companies to appoint non-executive independent directors, it merely recommends this as a practice.

The Code provides for representation of independent non-executive directors, on the board of directors of listed companies. This provision is voluntary in the code. Although the Code is mandatory for listed companies, the companies do not have to follow the provision that is of the utmost importance to the minority equity investor. The term independent director on a board is also not specified. Although the term "independent" is defined in the code, the definition is fairly broad and leaves plenty of room for competing interpretations. Moreover, the definition of "independent" does not address minority shareholder rights. The definition states,

> " Independent director means a director, who is not connected with the listed company, or its promoters, or directors, on the basis of family relationship and who does not have any other relationship, whether pecuniary or otherwise, with the listed company, its associated companies, directors, executives or related parties".

The definition does not specify the type of family relationship, therefore, someone as a distant cousin could be considered as non-independent because of a family relationship. The definition should not be as broad to make it meaningless and to exclude almost every qualified individual. Further, the term "any other relationship" is so vague that raises a question whether who should be an independent director.

Minority shareholder representation by independent directors is one of the main methods for protecting the minority shareholder investment in a corporation. Where as the Code does not

[4] Code of Corporate Governance Published by The Securities and Exchange Commission of Pakistan,(Islamabad,2002) page 1-2

define minority shareholder interests further the compliance with the provision in itself is voluntary that creates problem for minority equity investors.

5.3.4 Remuneration of Directors:

Although the appointment of independent directors is a voluntary requirement under the Code, however, it is hard to find people who are willing to serve as independent directors because the remuneration incentive is not in accordance with the duties or liabilities of directors. A study conducted for SECP in 2002, recommended that companies need to settle the issue of remuneration of independent directors to make the system more effective and efficacious. The remuneration being paid to non-executive directors per meeting is not sufficient as it ranges from Rs. 500 to Rs. 5000. Therefore, the issue of remuneration of non-executive directors and proper incentives for independent directors to serve on the board needs to be examined [4].A market based remuneration scheme may attract qualified directors who will be willing to take on the responsibilities and liabilities of such a position.[5]

5.5.5 De-listing:

In 2001, before the Code was implemented, the number of companies listed on the Karachi Stock Exchange was 747. Up to 31 December 2007, only 654 companies were listed on KSE[6]. The complete list of delisted companies since 2002 is mentioned in table 5.1. The reason for de-listing of these companies in addition to various other problems was the additional cost of complying with the Code of Corporate Governance as one of the reasons for de-listing. A common complaint about the Code is the increased cost of frequent financial reporting system required by the Code, especially the quarterly unaudited statements[7]. The study conducted in 2002, suggested that an additional cost burden of Rs 0.8-1.2 million mostly in form of additional meeting expenses, travel expenses, increased paper work and recruitment of additional staff has been imposed on a small company due to compliance with and enforcement of the provisions of the Code of Corporate Governance [8].

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[5] Impact Assessment of the Code of Corporate Governance 2002, Published by The Securities and Exchange Commission of Pakistan,(Islamabad,2002) page 27

[6] Source is Karachi Stock Exchange

[7] Karachi Stock Exchange, Available at web site www.kse.gov.pk. Visited on 29 March 2008.

[8] Impact Assessment of the Code of Corporate Governance 2002, Published by The Securities and Exchange Commission of Pakistan,(Islamabad,2002)page 3

5.5.6 The Role of the Financial Press:

The Pakistani financial press does not provide active deterrence, and as such fails to provide the additional level of enforcement necessary for good corporate governance. An active financial press that keeps shareholders inform of company developments is vital to minority shareholder protection. The Pakistani financial press is still developing and is not as active as it could be. A leading financial newspaper in March 2006, published a report when KSE was around 11,000 points which dropped some 400 points in one day when newspaper reported that foreign shareholders would have to declare their holdings to the government. Later it was discovered that this information was rumors and not appropriately verified by the newspaper. Consequently, a number of foreign investors pulled out of the market causing a drop in the KSE.[9]

5.6 Conclusion and Recommendations:

The following are the conclusions which are drawn from the study conducted in order to evaluate the state of corporate governance in Pakistan with the recommendations which are being suggested for the effective implementation of the Code.

1) The Code provides that 25% of board members be non-executive independent directors, representing financial institutions or minority shareholders. The ratio of non-executive independent directors will need to be reconsidered as this increase in members as non-executive independent directors will lead to more open discussion and encourage healthy criticism during the board meetings. The Impact Assessment of the Code of Corporate Governance 2002, Published by the Securities and Exchange Commission of Pakistan recommended that the number of non-executive independent directors should be 33% or 50% as suggested by the Hampel Report and Higgs Report respectively. The combined Code 2006, of England provides that except for smaller companies at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two

[9] Corporate Governance in a emerging market: A perspective on Pakistan by Haroon.H.Hamid & Valeria Kozhich. Journal of Legal Technology Risk Management Vol. I • fall 2006 • No.1page 28 available at http://www.ltrm.org/journal/vol1issue1/issue1vol1Hamid_.pdf.

independent non-executive directors. As non-executive director are independent and have ability to question the executive members of the board which can enhance the transparency in a company, further it provides independent checks and balances on the authority of executive directors and CEO, and therefore, ratio of non-executive independent directors be reconsidered and increase accordingly in order to make board meetings more transparent which ultimately enhance the shareholder faith on the company.

2) The issue of the remuneration of director's is not addressed in code. Clause viii (e) of the code provides that the remuneration of executive directors determined and approved by the board of directors. To make the remuneration procedure of the director's more transparent the board should establish a remuneration committee of independent non-executive directors. The combined Code 2006, of England provides that a remuneration committee should be formed and it should consists of at least three, or in the case of smaller companies two, independent non executive directors. Such remuneration committee should have responsibility for setting remuneration for all executive directors and the chairman. Whereas the remuneration of the non-executive directors be determined by the board of directors where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. The annual report of companies' should contain a statement of remuneration of each director.

3) The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board. Neither the Companies Ordinance 1984 nor the clause ix of the Code specifically preclude the possibility of the same person holding the office of Chairman and Chief Executive. The Code, however, lays down that the Chairman of a listed company is to be preferably, elected from among the non-executive directors and that the board of directors is to clearly define the respective roles and responsibilities of the Chairman and the Chief Executive, whether or not these offices are held by separate individuals or the same

individual. The chief executive is a full-time employee of the company and has the overall responsibility for the management of the company's affairs. The chief executive discharges these responsibilities subject to the powers given by the board of directors, the Chairman heads the board and is, therefore, responsible for ensuring that the statutory and fiduciary duties of directors are properly carried out and the board, as a whole, functions effectively. The Chairman is also expected to monitor the performance of directors as well as the chief executive. When the Chairman is independent from the management he can play a pivotal role in giving directors particularly the non-executive directors a strong voice in setting agendas of board meetings. The Chairman is also likely to take measures to require circulation of relevant information precisely, accurately and timely to non-executive directors for participating in board meetings. Thus, the board is likely to discharge its statutory and fiduciary responsibilities in a diligent manner. Keeping the two positions distinct will better safeguard shareholders' interests as the Chairman will keep an independent check on the chief executive and maintain an oversight function.

4) Clause xv of the Code provides the criteria for becoming the chief financial officer of the company. According to the Code any graduate with five years experience of listed companies or a bank or financial institutions can be appointed as the CFO of the company. A graduate in any discipline whether he is qualified accountant or not with five years experience of listed companies or a bank or financial institutions can be appointed as the CFO of the company. Now the question is that whether a graduate in any discipline can replace a qualified accountant having relevant qualification and experience? The information collected from the Institute of Chartered Accountants of Pakistan's web site reveals that there are more than 5000 qualified accountants in the country. Whereas the listed Companies are less than 1,000, and therefore the qualification of CFO should be restricted only to qualified Accountants for this highly professional.[10] This clause be reconsidered and only professional persons

[10] Role of Regulatory Authority under the Code of Corporate Governance by Mazara Iqbal .Available at web site http://www.icmap.com.pk/role_ccg.doc.

with relevant qualification and experience be appointed as the CFO of the company.

5) Clause iii of the Code provides the qualification and eligibility to act as a director of the company. According to this clause no director is allowed to serve on more than ten boards at one time. It is extremely difficult for a director to make useful contribution at ten Boards at one time. In view of this problem no director should be allowed to serve on more than 5 boards at one time. Which will able the director to serve the boards in an effective manner and make useful contribution to the companies'. A director is an officer of the company who is charged with the conduct and management of affairs of the company with increased responsibilities it is extremely difficult rather demanding for a director to make useful contribution at ten Boards at one time.

6) There are certain provisions in the code that confront with the provisions of Companies Ordinance 1984. For instance Clause xii of the code stipulates 30 days for the circulation of minutes of the meeting to directors, while the Companies Ordinance 1984, section 173 (1) provides 14 days for the circulation of minutes of the meeting. Which need to be rectified in order to harmonize code with the Companies Ordinance.

7) Clause VI of the Code provides 30 days time for filling a casual vacancy on the board. This time framework should be reconsidered and extended accordingly. Sufficient time should be provided to the company to find a suitable director with right credentials. The Impact Assessment of the Code of Corporate Governance 2002, Published by the Securities and Exchange Commission of Pakistan recommended 90 days instead of 30 days for filling a casual vacancy on the board.

8) Keeping in view the significance of audit committees in improving corporate governance practices, the Code of Corporate Governance requires all listed companies to constitute an audit committee. Majority of the members of the committee preferably its chairman must be drawn from among the non-executive directors of the company. Performance of the audit committee is linked to the

qualification and expertise of its members. Good corporate governance practices recognize that at least one member of the audit committee must possess knowledge of financial reporting and auditing. An audit committee cannot function effectively unless it understands the financial reports presented for its review and takes action to redress observations communicated by the auditors. Therefore, it is also suggested that at least one member of the audit committee to be finance expert. The Sarbanes-Oxley Act 2002 of USA required that the public firms to appoint an auditing committee comprised entirely of independent directors and at least one member must be qualified as a financial expert.

9) Before the implementation of the Code of Corporate Governance in 2001, there were 747 companies listed on the Karachi Stock Exchange. Till the end of December 2007, there were only 654 companies listed on KSE. The complete list of delisted companies since 2002 is mentioned in table 5.1. Since 2002 a large number of companies got themselves de-listed from the Stock Exchanges in Pakistan. Most of the companies who de-listed suffered from limited share float, illiquid shares, persistent losses and lack of ability to pay dividends. Only few companies have mentioned the additional cost burden of complying with the provisions of code of corporate governance as one of the reasons for de-listing. The reason for de-listing is operational and not the additional cost burden of complying with code.

In light of the key findings of the study regarding the progress made after the implementation of the Code of Corporate Governance 2002 and major obstacle in the way of effective implementation of the Code one can say that the Code should continue to be applied to all the listed companies without any discrimination. The companies should be encourage and motivate to make greater efforts to implement the Code in letter and spirit. Realizing the significance of having non-executive directors on boards of companies, the Code encourages representation of independent non-executive directors. Accordingly, listed companies are encouraged to give at least 25% representation to non-executive directors on their boards and appoint a non-executive director as the chairman of the board. Moreover, majority of members of the audit committee and, preferably, its chairman must be from among the non-executive directors. The ratio of non-executive independent directors will

need to be reconsidered as this increase in members as non-executive independent directors will lead to more open discussion and encourage healthy criticism during the board meetings.

To make the remuneration procedure of the director's more transparent. The board should establish a remuneration committee of independent non-executive directors. It is recommended that the Securities and Exchange Commission of Pakistan should issue guidelines on formalizing such Committees in the companies and the annual report of companies' should contain a statement of remuneration of each director. The roles of chairman and chief executive should not be exercised by the one person. Keeping the two positions distinct will better safeguard shareholders' interests as the Chairman will keep an independent check on the chief executive and maintain an oversight function.

To make positive and meaningful contribution in the board and committee meetings it is recommended that no director should be allowed to serve on more than 5 boards at one time. presently the directors are allowed to sever on 10 boards at one time . It is also important to mention here that there are certain provisions in the code that confront with the provisions of Companies Ordinance 1984. For instance Clause xii of the code stipulates 30 days for the circulation of minutes of the meeting to directors, while the Companies Ordinance 1984, section 173 (1) provides 14 days for the circulation of minutes of the meeting. Which need to be rectified in order to harmonize code with the Companies Ordinance. For the effective implementation the Code it is also recommended that Clause VI of the Code should be reconsidered as this clause provides 30 days time for filling a casual vacancy on the board. This time framework should be reconsidered and extended accordingly. Sufficient time should be provided to the company to find a suitable director with right credentials.

Table 5.1 list of de-listed companies

YEAR	DELISTED COMPANIES	DATE OF DELISTING	
2007	Dawood Fibre Mills limited *	12/02/2007	
	Haroon Oils Limited *	19/03/2007	
	Ahmed Spinning Mills Limited *	18/06/2007	
	AKD Index Tracker Fund **	02/07/2007	
	Sarhad Cigarette Industries Limited *	06-08-2007	
	Noon Textile Mills Limited *	01-11-2007	
YEAR	DELISTED COMPANIES	DATE OF DELISTING	
2006	Tobacco Internation Limited *	27/08/2006	
	Associated Industries Limited *	10/10/2006	
	Lafayette Industries Synthetics Limited **	13/10/2006	
	Asian Leasing Corporation Limited **	27/11/2006	
	Chenab Textile Mills Limited *	26/12/2006	
YEAR	DELISTED COMPANIES	DATE OF DELISTING	
2005			
	Tritex Cotton Mills Limited *	03/01/2005	
	Maqbool Company Limited *	17/01/2005	
	Reckitt Benckiser Pakistan Limited *	28/02/2005	
	Zafara Internationial Limited *	17/03/2005	
	Farooq Habib Textile Mills Limited *	28/03/2005	
	Orient Straw Board & Paper Mills Limited *	28/03/2005	
	Sh. Fazal Rehman & Sons Limited *	06/06/2005	
	Shaigan Electric & Engineering Company Ltd.*	27/06/2005	
	Crescot Mills Limited *	28/07/2005	
	Valika Art Fabrics Limited *	12/09/2005	
	Shafiq Textile Mills Limited *	26/09/2005	

	Pakistan Capital Market Fund *	15/11/2005
	Parke, Davis & Company Limited *	19/12/2005
	Kohinoor Oil Mills Limited *	19/12/2005

YEAR	DELISTED COMPANIES	DATE OF DELISTING
	F.P. Textile Mills Limited *	02/01/2004
	Pakistan Fisheries Limited *	09/01/2004
	Lease Pak Limited*	30/03/2004
	Star Textile Mills Limited*	09/04/2004
	Pioneer Cables *	27/04/2004
	Spencer & Company (Pakistan) Limited *	11/05/2004
	Alhamd Textile Mills Limited *	11/06/2004
	Kotri Textile Mills Limited *	25/06/2004
2004	Indus Jute Mills Limited *	28/06/2004
	Al - Husainy Industries Limited ***	16/06/2004
	Shahyar (O. E.) Textile Mills Limited ***	16/06/2004
	National Security Insurance Co. Limited *	26/07/2004
	Elite Textile Mills Limited *	26/07/2004
	Polypropylene Products Limited *	02/08/2004
	Hamza Sugar Mills Limited *	06/09/2004
	Bengal Fibre Industries *	25/10/2004
	Zaman Textile Mills Limited *	27/12/2004
	Refrigerator Manufacturing Company Ltd. ***	28/12/2004
2003	Burma Oil Mills Limited *	10/02/2003
	National Tanneries of Pak Ltd. *	24/03/2003
	Hilal Flour & General Mills Ltd. *	24/03/2003
	Latif Cotton Mills Ltd. *	30/04/2003

	Asia Board Industries Ltd. *	30/04/2003
	Universal Leather & Footwear Ind. Ltd. *	12/05/2003
	Souvenir Tobacco Co. Ltd. *	17/06/2003
	Elite Publishers Limited *	09/12/2003

YEAR	DELISTED COMPANIES	DATE OF DELISTING
2002	Benz Industries Limited *	25/03/2002
	Bankers Equity Limited **	30/04/2002
	Indus Bank Limited **	30/04/2002
	Central Cotton Mills Limited **	30/04/2002
	Nusrat Textile Mills Limited **	30/04/2002
	Sadiqabad Textile Mills Limtied **	30/04/2002
	Crown Textile Mills Limited **	30/04/2002
	Aswan Tentage & Canvas Mills Limited **	30/04/2002
	Marr Fabrics Limted **	30/04/2002
	Nilom Nylon Mills Limited **	30/04/2002
	Karachi Pipe Mills Limited **	30/04/2002
	Multipole Industries Limited **	30/04/2002
	Hyderabad Electronics Industries Limited **	30/04/2002
	Sarhad Ghee Mills Limited **	30/04/2002
	Punjab Lamps Works Limited **	30/04/2002
	Kaytex Mills Limited **	30/04/2002
	Bari Rice Mills Limited *	23/09/2002
	Musarat Textile Mills Limited *	30/09/2002
	MFMY Industries Ltd *	21/10/2002
	Abbas Engineering Ind. Ltd. *	21/10/2002
	Ahmed Oriental Textile Mills Ltd. *	29/11/2002
	Ravi Rayon Limited *	23/12/2002
	Anwar Textile Mills Limited *	

Name of the Organization

Contact person name and telephone number

Questionnaire

Please tick all the relevant options applied and adopted by your company

1. Are minority shareholders facilitated to contest election for the company's board of directors?

   a) Yes
   b) No
   c) Don't know

2. Does your company's board of directors include independent directors?

   a) Yes
   b) No
   c) Don't know

3. Has the Chairman of Board of Directors been elected from?

   a) Executive Directors
   b) Non- Executive Directors

4. What is the share of executive directors in your company?

   a) 50%
   b) 75%
   c) 25%
   d) Others please specify.

5. Has your company taken steps against directors serving in other companies?

   a) Yes
   b) If yes how often,
   c) Don't know.
   d) Under consideration

6. How many directors are national tax payers in your company's board of directors?

   a) All
   b) Majority of them
   c) Few of them

d) Others, please specify

7. Has your company prepared Statement of Ethics and Business Practices after the introduction of the Code of Corporate Governance?

a) Yes
b) No
c) Under consideration

8. Has your company prepared Statement of Ethics and Business Practices before the introduction of the Code of Corporate Governance?

a) Yes
b) No
c) Sometimes
d) Don't know

9. The meetings of the board of directors of your company are held:

a) Once in every quarter
b) Once in every six months
c) Once in a year
d) On need basis

10 Are the minutes of the meeting properly recorded in the minute's book & subsequently circulated to the Director within 30 days of the meeting for their comments?

a) Always
b) Sometimes
c) Quite often

11. The number of training courses conducted by your company to acquaint the staff with their duties and responsibilities of management are:

a) Less than five
b) More than five
c) More than ten
d) Others, please specify

12. How shareholders are informed about the financial statements of your company?

a) In annual report
b) Directors report to shareholders
c) Through mail
d) Others, please specify

13. What is the frequency of the financial reporting framework of your company?

a) Quarterly unaudited financial statements
b) Half- yearly financial statements
c) Annual audited financial statements
d) Others, please specify

14. What %age of share capital is offered in the stock exchange by your company?

a) 10%
b) 20%
c) 30%
d) others please specify

15. The external auditors of your company are appointed for a period of

a) One year
b) Two years
c) Three years
d) Others, please specify

16. How often the external auditors of your company changed

a) After two years
b) After five years
c) After ten years
d) Other, specify

17. Has your company submitted a statement of compliance along with the annual report?

a) Yes
b) No
c) Under consideration

18. Has SECP effectively enforced key provisions of the Code of Corporate Governance?

a) Completely
b) To some extent

19. What type of action has been taken against the directors who have been convicted?

a) Removal from the board
b) Never happened

20. Has an Audit Committee been established in your Company?

a) Yes
b) No

21. The Chairman of the Audit Committee is elected from

a) Executive Director
b) Non-Executive Director

22. What are your suggestion regarding the effective implementation of the Code of Corporate Governance

Appendix A

Table 4.1 List of Companies to whom the Questionnaire was dispatched

1. Cherat Cement Company Limited
   Modern motors House, Beamont road, Karachi
2. D.G Khan Cement Company Limited
   Nishat House, 53-A, Lawrence road, Lahore
3. Fecto Cement Limited
   35- Darulaman Housing society, Block 7/8, Shahrah-e-Faisal, Karachi
4. Kohat Cement Company Limited
   House No 64 -E-I / D, Gulberg-III, Lahore
5. Lucky Cement Company Limited
   6-A, Muhammad Ali Housing society,
   A.Aziz Hashim Tabba Street, Karachi
6. Pakistan Cement Company Limited
   3 rd Floor, Habib Bank Tower, Jinnah Avenue, Blue Area, Islamabad
7. Pioneer Cement Company Limited
   7th Floor, Lakson Square Building No 3,
   Sarwar Shaheed Road, Karachi
8. Deawan Hattar Cement Company Limited
   Hattar Industrial Estate, Haripur
9. Best way Cement Company Limited
   Hatter Industrial Estate, Haripur
   Registered Office Best way House, F 7/2, Islamabad
10. Saudi Pak Leasing Company Limited
    2nd Floor, High Rise Block, Saudi Pak Tower,
    Jinnah Avenue, Blue Area, Islamabad
11. Orix Leasing Pakistan Limited
    Overseas Investors Chamber of Commerce Building
    Talpur Road, Karachi
12. Union Leasing Company Limited
    6th Floor, New Jubilee Insurance House

I.I.Chundrigar Road, Karachi

13. Askari General Insurance Company Limited

    101-F, Fazal-ul-Haq Road. Blue Area, Islamabad

Appendix B

Table 4.2 List of Companies that Responded to the Questionnaire

1. Saudi Pak Leasing Company Limited
   2nd Floor, High Rise Block, Saudi Pak Tower,
   Jinnah Avenue, Blue Area, Islamabad
2. Best way Cement Company Limited
   Hatter Industrial Estate, Haripur
   Registered Office Best way House, F 7/2, Islamabad
3. Askari General Insurance Company Limited
   101-F, Fazal-ul-Haq Road. Blue Area, Islamabad

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1. A.F Ferguson & Co Versus The Securities and Exchange Commission of Pakistan, 2004 CLD1433(a)
2. Aminuddin Versus Azad Friends and company. 2002 CLD 1519
3. Bacha F. Guzdar versus CIT. AIR 1955 SupremCourt 74
4. Chief Executive Barex Limited Versus Executive Director (Company Law Division).2002 CLD 1309
5. Dawood Fibre Limited versus Executive Director (Company Law Division). 2006 CLD 283
6. Diamond Industries Limited versus Appellate Bench of Security and Exchange Commission of Pakistan. 2002 CLD 1714
7. Gang at & Co, Chartered Accountants Versus Executive Director (Company Law Division).2007 CLD 1256
8. In the matter of General tyre and Rubber Company of Pakistan Limited. 2006 CLD 1060
9. In the matter of M/s. Quice Food Industries limited. 2006 CLD 542
10. In the matter of M/s. Macdonald Layton Company Limited. 2006 CLD 667
11. In the matter of: Messrs Sarwar Awan & Company. 2006 CLD 431
12. Institute of Chartered Accountants of Pakistan v. Messers Hyderali Bhimji & Co. 2002 CLD 1207.
13. Kohinoor Raiwind Mills Limited v. Kohinoor Gujar Khan. 2002 CLD 1314.
14. Mansha Mohsin Dossani Khan & Company Chartered Accountants versus Executive Director (Company Law Division). 2006 CLD 399

15. Messrs Netsol Technologies Limited versus Executive Director (Company Law Division) 2006 CLD 684
16. Muhammad Bakhsh & Sons Limited versus Azhar Wali Muhammad. Published in 1986 MLD 1870
17. Mian Muhammad Ilyas Mehraj and Others versus Executive Director (Company Law Division) 2007 CLD 297
18. Quality Steel Works Limited versus Executive Director (Company Law Division). 2007 CLD 1116
19. Ramaswamy Iyer Versus Bramayya & Co.1966 Companies Law journal 107
20. Shah Rafi Alam versus Lahore Race Club. 2004 CLD 373(a)

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2 Corporate Governance for Listed Companies in China. www.csrc.gov.cn.

3 Corporate Governance: The Combined Code and Its Source Documents (UK corporate governance codes and other related books) http://www.gee.co.uk/

4 Comparative Corporate Governance : The State of the Art and Emerging Research (edited by Klaus J. Hopt; Oxford : Clarendon Press ; Oxford ; New York : Oxford University Press, 1998)http://www.oup.co.uk/isbn/0-19-826888-2

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6 Corporate Law: Finance and Corporate Governance Law Abstracts (e-journal) http://www.ssrn.com/update/lsn/lsn_corp-governance.html

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8 Corporate Governance Codes, Principles and Recommendations http://www.ecgi.org/codes_and_principles.htm http://www.ecgn.ulb.ac.be/ecgn/codes.htm

9 European Corporate Governance Institute http://www.ecgi.org/

10 International Corporate Governance Network http://www.icgn.org/)

11 Karachi Stock Exchange. Kse.gov.pk

12 Largest Corporate Bankruptcies www.bankruptcydata.com

13 OECD Principles of Corporate Governance

http://www.oecd.org/daf/governance/principles.htm

http://www.oecd.org/daf/corporate-affairs/governance/

14 Principles of Corporate Governance: Analysis and Recommendations(American Law Institute, 1994) http://www.ali.org/ali/stu_corp_gov.htm

15 Pakistan Institute of Corporate Governance. http://www.picg.org.pk/

16 Securities and Exchange Commission of Pakistan. http:// www.secp.gov.pk/

17 State Bank of Pakistan, http://www.sbp.org.pk/about/index

18 .The Encyclopedia about Corporate Governance http://www.encycogov.com/

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20 The McKinsey Quarterly, a business journal by Mckinsey & Company. http://www.mckinsey.com

21 World Council for Corporate Governance http://www.wcfcg.net/

22 World Bank Group, Corporate Governance: Best Practices

http://www.worldbank.org/html/fpd/privatesector/cg/codes.htm

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